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EUROPE 1992: LONG-TERM IMPLICATIONS FOR THE U.S. ECONOMY.

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EUROPE 1992: LONG-TERM IMPLICATIONS FOR THE U.S. ECONOMY

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

APRIL 26, 1989

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EUROPE 1992: LONG-TERM IMPLICATIONS FOR THE U.S. ECONOMY

WEDNESDAY, APRIL 26, 1989

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met, pursuant to notice, at 10:30 a.m., in room 2325, Rayburn House Office Building, Hon. Lee H. Hamilton (chairman of the committee) presiding.

Present: Representatives Hamilton, Scheuer, Solarz, and Fish.

Also present: Hunter Monroe and William Buechner, professional staff members.

OPENING STATEMENT OF REPRESENTATIVE HAMILTON, CHAIRMAN

Representative HAMILTON. The Joint Economic Committee will come to order.

This morning the Joint Economic Committee continues its hearings on the European Community's program to eliminate internal trade barriers by 1992.

Today's hearing will examine the long-term implications of Europe 1992 for the U.S. economy and for economic relations between the United States and the European Community.

The United States-European Community economic relationship is the largest in the world. We are each other's biggest customer, particularly when foreign investment is included.

In addition, the United States-European Community trade balance has recently changed from deficit to surplus. More importantly, 40 percent of the improvement in the total U.S. trade balance has been trade with the EC.

This morning the committee will examine how European integration will affect this strong relationship.

This committee is very pleased to have three experts on economic relations between the United States and Europe:

Mr. Stephen Cooney, who is the director of international investment and finance for the National Association of Manufacturers; Mr. Gary Horlick, international trade attorney, O'Melveny & Myers; and Mr. Seamus O'Cleireacain, Institute on Western Europe, Columbia University, New York.

Gentlemen, we are very pleased to have you. We will, of course, take your prepared statements and enter them into the record in full, and we will begin now with your testimony.

Mr. Cooney, before you begin, I have an opening statement of Congressman Upton for the hearing record. Without objection, it will be placed in the record at this point.

[The written opening statement follows:]

WRITTEN OPENING STATEMENT OF REPRESENTATIVE UPTON

I join Chairman Hamilton in welcoming this morning's distinguished list of witnesses who will be testifying before this Committee on "Europe 1992". The subject is an important one for the Congress as it seeks to obtain a better understanding of how Europe's most recent steps toward economic unification might influence America's trade and investment policies in the 1990s and beyond.

The European Community (E.C.) constitutes a vital external market for the United States. Because I am a representative from the state of Michigan, this reality has special relevance in the manufacturing sector. As Stephen Cooney, one of our witnesses, points out in a new report by the National Association Of Manufacturers, "the E.C. is far and away the most important host for U.S. manufacturing abroad--at $65 billion, more than half the world wide total".[1]

But U.S. agricultural exports to the E.C. are no less significant for me. Here too, the European Community counts as one of our most important customers--and should continue to be for the forseeable future. So, in sum, I think I can speak for my colleagues in viewing these new strides with the strong expectation that our traditionally close ties with Europe will, if anything, be strengthened by these moves.

It would be unrealistic, however, to conclude on a totally optimistic note. As in the past, the United States recognizes that Europe's economic integration inevitably raises longer term adjustment problems for us. And those problems will require a high degree of ingenuity and will to surmount. Let me briefly address two of them:

First, with respect to global trade developments, we hope that the inevitable result of "Europe 1992" will not result--through design or accident--in more exclusionary practices against its non-European partners, including the United States. If this were to occur, the open trade system all of us have worked to create could suffer a mortal blow.

Second, on a more specific level, a number of sectoral issues involving "Europe 1992" concern me, beginning with agricultural trade. Carla A. Hills, our new U.S. Trade Ambassador, deserves a word of thanks from all of us for the recent breakthroughs she negotiated in Geneva on progressively dismantling trade distorting subsidies and protection in agriculture.

But the matter cannot be left there. In the end, only Europe can muster the necessary political will to tackle its agricultural barriers in a manner which removes this obstacle from our bilateral trade agenda. The clock is ticking.

With these considerations in mind, I look forward to a lively dialogue. Thank you.

[1] "E.C.-92 and U.S. Industry", NAM, February 1989, pg. 2.

Representative HAMILTON. Mr. Cooney, would you begin, please.

STATEMENT OF STEPHEN COONEY, DIRECTOR, INTERNATIONAL INVESTMENT AND FINANCE, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. COONEY. Thank you very much, Mr. Chairman.

I congratulate the JEC for starting the process of hearings on EC-92 last autumn.

I am Stephen Cooney, director of international investment and finance for the National Association of Manufacturers, and I have recently been responsible for writing an NAM report summarizing the European Community's internal market program and its possible effects on our members and their views and concerns.

I would like to submit this report, "EC-92 and U.S. Industry," with my prepared statement. I believe you have already sent it up to the committee.

Representative HAMILTON. Yes. That report will be entered into the record in full.

Mr. COONEY. Thank you.

In today's statement I would like to focus more on the probable macroeconomic and trade effects for the U.S. of EC-92, but I would be pleased to discuss other aspects of the subject covered in the report with committee members after the panel has completed its testimony.

Now let me summarize first my main conclusions on the general question of trade trends with the EC.

First, I believe a successful EC-92 program will be positive for U.S. trade.

Second, we believe that all U.S. manufacturing companies should benefit, both exporters and those with substantial investments already in Europe.

And, third, these U.S. export opportunities could be reduced by a protectionist EC-92 program, but this is unlikely to develop, at least across the board.

My major overall point is that U.S. companies almost uniformly emphasize that EC-92 represents a major market opportunity. We see the proposed package as contributing both to a rapid expansion of the EC market and in practice a deregulation of that market which will increase opportunities for competitive producers.

Today about a quarter of total U.S. exports go to the European Community, which has just overtaken Canada as the largest regional or national market, a point you made in your opening statement. Just by comparison, if you look at the other markets, Japan takes 8 percent of our exports, the rest of East Asia another 13 percent and all of Latin America only 13 percent.

Furthermore, as you also mentioned, the EC market has been the most important one so far in turning around the U.S. trade deficit. U.S. export growth to Europe has been near or above double figures since 1985 and has been accelerating, 9 percent in 1986, 14 percent in 1987, and an incredible 25 percent in 1988.

This export growth in 1988 cut the bilateral U.S. trade deficit with the EC by more than half, from $21 billion in 1987 to $9 billion in 1988. That's using customs value imports. And that alone, as you have indicated, is more than a third of the total improvement of the U.S. trade deficit in 1988.

Two factors, the dollar exchange rate and EC growth, dominate demand for U.S. exports in the EC, as indicated in the table that I have included with the prepared statement.

So, for example, at the end of the 1970's we saw strong U.S. export growth, together with a falling dollar and positive overall EC growth levels. In the early 1980's, by contrast, all three trends reversed. The EC growth fell dramatically, the dollar rose at an average rate of over 12 percent per year and real U.S. exports to the EC fell by 7 percent per year.

In 1984, EC growth turned strongly upward again, and the next year the dollar started to fall. Between 1984 and 1988 the rate of the dollar's fall was about twice the rate of its fall in the late 1970's, about 9.5 percent per year to 5 percent per year. As a consequence, the real value of the U.S. exports to the EC in the late 1980's has increased by almost 13 percent a year.

Now the implication of this performance is clear. U.S. exports to Europe will only grow if European growth remains strong and if the dollar remains at a competitive level. U.S. companies, whether as investors in the EC or as exporters, can benefit substantially from both the immediate deregulatory aspects of the EC–92 program and from the longer term aspects of a freer and more dynamic EC market at a higher growth level.

A second aspect that I want to mention here is the reduction of the overall U.S. trade deficit. Recovery of a balanced U.S. trade account, which NAM has supported as a major national economic goal, will at a minimum probably require restoration of a U.S. trade surplus with the EC.

The United States, we believe, can improve our trade deficit with the EC by another $20 billion, thereby moving strongly into surplus from our 1988 deficit, only under conditions of sustained EC growth. And EC growth will not only directly increase demand for U.S. exports, but will reduce the social impact and resulting pressure of trade restrictions that may be caused by rising U.S. exports in a slower growth Europe.

Many of our members also feel, incidentally, that growth related to EC–92 will occur earlier than expected and not be dominated by the restructuring problems emphasized by the Commission and others. I guess in a certain respect you can say some of our members are more positive on this subject than the European Commission itself.

There is one other important caveat I want to explore before I look at the other two issues, and that's the dollar exchange rate. As this committee well knows, the overall fall in the dollar indicated in the table of the prepared statement has been halted and even reversed over the past year. Over the past year the dollar has risen about 11 percent against the deutsche mark compared to only 3 percent against the yen, 7 percent against sterling, which remains outside the European monetary system, and 8 percent against the overall U.S. G–10 exchange rate index.

Now basically these disparities of figures, the strong German current account growth on the one hand, but on the other hand the depreciation of the dollar against the deutsche mark, tend to reinforce the view that Germany's currency is too weak by comparison to most of its EC partners. This contributes to the massive German current account surplus, it hinders U.S. competitiveness against German products within the EC and I think it also has the effect, which is not mentioned in my prepared statement, that it tends to reduce growth within Europe as a whole and therefore overall demand for U.S. exports.

Now the recent G-7 statement regarding the inadvisability in particular of further dollar depreciation indicates growing concern in the Treasury on this subject.

To conclude on this point, and I'm not trying to predict where the dollar is going to go, but I want to state that my remarks regarding the positive opportunities for U.S. exports over the next few years as a result of increasing European deregulation and growth, presume no major changes in the exchange level of the dollar and certainly no appreciation of the dollar during that period.

Now let me look at the other two subjects that I mentioned very briefly.

The first is the relationship between U.S. trade and investment in the EC. Although most major investors in the European Community produce a large proportion of their locally sold products in Europe, it's important to recognize that most are also siginificant exporters to Europe.

Moreover, many small companies sell their products in the EC through their inclusion as components of products sold by the larger companies with investments in Europe. Thus, according to the latest available Commerce Department data, about 34 percent of all U.S. exports to the EC go directly to the affiliates of U.S. companies with direct investments there.

One reason for this is the predominance of capital goods in U.S. exports. Over a third of all U.S. exports in 1988, for example, consisted of manufactured capital goods. That's all exports. The EC is by far the most important market for these capital goods exports.

Hence, the relationship between exporting and investment in the EC is not a zero-sum game as some fear. We are certainly opposed, by the way, to EC policies which try to force to distort investing, but we are not concerned about rising levels of U.S. investment to pursue economic opportunities. Increased U.S. investment in the EC is likely to draw increased U.S. exports rather than displacing existing exports.

Finally, and the big question that is being asked here, is EC-92 protectionist? It is our belief that strong forces are at work to make sure that EC-92 is not being driven by protectionist trade strategy. There will not be a general policy aimed at reducing exports from the United States to Europe.

For example, I would cite for the committee a recent comprehensive statement on this subject by the German industry confederation, BDI, which clearly condemns any effort to adopt policies aimed at establishing EC-wide quotas or other trade restrictions to replace those existing today at the national level as the internal market comes fully into effect.

Now this coincides with our conclusion at NAM that if the EC is to become more globally competitive through EC-92, they cannot simultaneously adopt a protectionist trade strategy. We foresee a much higher degree of global market integration and reliance on use of non-EC technologies and not less resulting from this process. Therefore, we think there will be more need to import goods to the EC from non-EC sources and not less.

All this does not mean that we should ignore the impact of restrictive or trade-distortive policies in specific areas. We have conveyed our concerns regarding such policies directly to representatives of the European Community, to the executive branch agencies in the United States and in previous testimony, particularly before the Ways and Means Committee, to Congress.

I would be pleased to discuss these concerns in more detail here, but to sum up our position overall I would like to use a quote from Oliver Cromwell and change it around a little bit. We put our trust in the EC, but let's keep our powder dry.

Representative HAMILTON. Mr. Cooney, thank you very much.

[The prepared statement of Mr. Cooney, together with the report entitled "EC–92 and U.S. Industry," follows:]

PREPARED STATEMENT OF STEPHEN COONEY

The Implications of the European Community 1992 Plan

Mr. Chairman, I am Stephen Cooney, Director of International Investment and Finance for the National Association of Manufacturers. NAM is a voluntary business association of over 13,500 manufacturing companies of all sizes, and their subsidiaries. Our members employ over 85 percent of all U.S. workers in manufacturing. They produce over 80 percent of the nation's manufactured goods and a similar share of the nation's total manufactured exports.

I have recently been responsible for writing an NAM report summarizing the European Community's Internal Market Program (EC-92), its possible effects on our members, and their views and concerns. I would like to submit this report, EC-92 and U.S. Industry with my written statement. In today's statement I would like to focus more on the probable macroeconomic and trade effects for the United States of EC-92. I would be pleased to discuss other aspects of the subject covered in the report with committee members after my testimony.

Let me first summarize my main conclusions:

- **A successful EC-92 program will be positive for U.S. trade;**
- **All U.S. manufacturing companies should benefit, both exporters and those with substantial investments already in Europe;**
- **These U.S. export opportunities could be reduced by a protectionist EC-92 program, but this is unlikely to develop.**

The EC-92 Market Opportunity for U.S. Exports

My major overall point is that U.S. companies almost uniformly emphasize that EC-92 represents a major market opportunity. We see the proposed package as contributing both to a rapid expansion of the E.C. market and, in practice, a deregulation of that market which will increase opportunities for competitive producers.

Let's first look at the scale of the market opportunity. By the European Commission's calculations, enactment of the full 1992 program can give a one-time boost of 5 percent or more to the total E.C. domestic product. While U.S. exporters should seek markets wherever they can find them, for the foreseeable future the E.C. may remain the key growth market overseas for U.S. industrial companies, especially if it becomes more dynamic and open.

Europe is our most important regional export market, and will probably remain so indefinitely. Today about a quarter of total U.S. exports go to the European Community, which has just overtaken Canada as the largest regional or national market. As for other countries and regions, Japan takes only 8 percent of our exports and the rest of East Asia another 13 percent. All of Latin America takes only 13 percent. And most importantly, no other regional market approaches the level of economic integration found in Europe today, much less what is being contemplated by 1992.

The E.C. market has been the most important one so far in turning around the U.S. trade deficit. As we noted in NAM's comprehensive trade report of December 1988, the fall of the dollar has had a bigger and faster impact on growth in exports to Europe than any other region. U.S. export growth to Europe has been near or above double figures since 1985 and has been accelerating -- 9 percent in 1986, 14 percent in 1987 and an astonishing 25 percent in 1988. The additional annual rate of exports generated - $27 billion - is roughly equal to our annual rate of exports to Japan. That is some indication of the size of the market we are dealing with here.

Moreover, this export growth in 1988 cut the bilateral U.S. trade deficit with the E.C. by more than half: from $21 billion in 1987, to $9 billion in 1988 (U.S. imports measured customs value). That improvement alone accounted for more than a third of the total improvement of the U.S. trade deficit in 1988.

The table below clearly indicates that two factors - the dollar exchange rate and E.C. growth - dominate demand for U.S. exports in the E.C. Thus, it is the recovery of growth in the E.C. plus the fall in the dollar since 1985 that have primarily caused the big growth in U.S. exports and the reduction of the U.S. trade deficit with the E.C. This is entirely in keeping with economic models of international trade, and indicates that the U.S. and E.C. economies co-exist in a generally market-oriented relationship, whatever the distortions or imperfections introduced by de facto trade barriers.

U.S. EXPORTS TO THE EUROPEAN COMMUNITY, COMPARED TO DOLLLAR EXCHANGE RATE AND E.C. GROWTH TRENDS

1978-1988

	$U.S. Exchg. Rate (G-10 Index) % Avg. Ann. Chg.	E.C. Real Growth % Avg. Ann. Chg.	U.S. Export Chg. (Real $1982) % Avg. Ann. Chg.
1978-80	- 5.4	2.5	11.0
1981-84	12.2	1.3	- 6.9
1985-88	- 9.5	2.9	12.9

Sources: Economic Report of the President, 1989
OECD Economic Outlook, no. 44 (December 1988)
OECD Trade Statistics, Series A
European Commission, Annual Economic Report, 1988-89

The table, which covers the last decade, shows three distinct periods in performance of U.S. exports to the E.C., systematically linked with exchange rates and E.C. growth performance.

- At the end of the 1970s, we saw strong U.S. export growth, together with a falling dollar and positive overall E.C. growth levels. Note that the table uses real export growth, corrected by the U.S. GNP deflator for export prices, to eliminate the big impact of inflation in the late 1970s on dollar export values.
- In the early 1980s, all three trends reversed: E.C. growth fell dramatically, the dollar rose at an average rate of over 12 percent per year, and real U.S. exports to the E.C. fell at 7 percent per year.
- In 1984 E.C. growth turned strongly upward again. And in the next year, the dollar started to fall -- between 1984 and 1988, the rate of the dollar's fall was about twice the rate of its

fall in the late 1970s. As a consequence, the real value of U.S. exports to the E.C. in the late 1980s has increased by almost 13 percent per year.

The implication of this performance is clear: U.S. exports to Europe will only grow rapidly if growth remains strong and if the dollar remains at a competitive level. One of the reasons that NAM members are strongly encouraged by the EC-92 program, is that it is viewed as a deregulatory, market-oriented program that escapes the old problems of "Eurosclerosis" by seeking to place the E.C. in a better position for long-term growth. U.S. companies, whether as investors in the E.C. or as exporters, can benefit substantially from both the immediate deregulatory aspects of the program - which will strike mainly at the vested interests of E.C.-based "national champions" - and from the longer term aspects of a freer and more dynamic E.C. market at a higher growth level.

A second aspect from the U.S. policy perspective is the reduction of the overall U.S. trade deficit. We have just "celebrated" the first improvement in U.S. trade performance since 1981. Can that improvement be sustained? I just indicated that over a third of our trade deficit improvement in 1988 was accounted for by reduction in the deficit with the E.C. Recovery of a balanced U.S. trade account, which NAM has supported as a major national economic goal, will at a minimum probably require restoration of a U.S. trade surplus with the E.C. In 1981, the U.S. had a surplus of $11 billion with the E.C. (U.S. imports customs value). The United States can get back to this level - thus improving our trade balance with the E.C. by another $20 billion - only under conditions of sustained E.C. growth.

E.C. growth will not only increase demand directly for U.S. exports, but it will reduce the social impact and resulting pressure of trade restrictions that may be caused by rising U.S. exports in a slow-growth Europe. And unlike the European Commission and some other commentators, many of our members feel that growth related to EC-92 will occur earlier than expected, and not be dominated by the restructuring problems emphasized by the Commission and others. Not only are many of the key directives going into effect well before the December 31, 1992 deadline, but companies are making major changes in their cross-border relationships and otherwise improving efficiencies now, in anticipation of major market changes. In this respect, EC-92 may be a self-fulfilling prophecy.

The dollar exchange rate. As this committee well knows, the overall fall in the dollar indicated in the table has been halted and even reversed over the past year. This reversal has been particularly sharp against the Deutsche mark and the currencies linked closely to it through the European Monetary System (EMS). Over the past year, the dollar has risen about 11 percent against the DM, compared to only 3 percent against the yen, 7 percent against sterling (which remains outside the EMS) and 8 percent against the overall G-10 exchange rate index.

The latest Morgan Guaranty effective exchange rate index, which calculates exchange rate changes corrected for relative inflation performance, now values the DM as only 3 percent over its average 1980-82 average level. France's currency is roughly at the earlier parity level, Italy is almost 8 percent over, Netherlands somewhat under, and Belgium over 20 percent lower. This disparity of figures reinforce the view that Germany's currency value is too weak by comparison to most of its EC partners, contributing to the massive German current account surplus, and hindering U.S. export competitiveness against German products within the EC.

The recent G-7 statement regarding the inadvisability in particular of further dollar appreciation indicates growing concern in the Treasury and other finance ministries regarding such a development. These comments regarding U.S. trade prospects in Europe presume no major changes in the exchange level of the dollar. Certainly, a further increase in the dollar could derail U.S. export growth and the correction of the trade deficit.

The Relationship Between U.S. Trade and Investment in the E.C.

For all U.S. manufacturers, total holdings in the E.C. were officially valued at $65 billion at the end of 1987. That's more than half the total value of all U.S. companies' manufacturing investment abroad. Although most major U.S. investors in the E.C. produce a large proportion of their locally sold products in Europe, it is important to recognize that most are also significant exporters to Europe.

Moreover, many small U.S. companies sell their products in the E.C. through their inclusion as components of products sold by the larger companies with investments in Europe. Thus, according to the last available Commerce Department data, about 34 percent of all U.S. exports to the E.C. go directly to the affiliates of U.S. companies with direct investments there. Typically, for U.S. exporters, direct investments abroad form an important export beachhead. This point is often not appreciated in policy analysis.

The reason is because of the predominance of capital goods in U.S. exports. Over a third of all U.S. exports in 1988, for example, consisted of manufactured capital goods. The $109 billion total was equal to three times the total value of agricultural exports, for example. The E.C. is by far the most important market for capital goods exports -- computers, aircraft, semiconductors, scientific instruments are among those important capital goods for which a third to a half of all foreign shipments go to the E.C. Typically, when a U.S. company increases its investment abroad - whatever the product it is making - it will rely on U.S.-made capital goods or will use U.S.-made components and sub-assemblies in the final product.

Hence the relationship between exporting and investment in the E.C. is not a "zero-sum" game, as some fear. Increased U.S. investment in the E.C. is likely to draw increased U.S. exports, rather than displacing existing exports.

Is EC-92 Protectionist?

Many members of Congress have expressed concerns regarding protectionist E.C. policies that would reduce potential U.S. trade resulting from EC-92. As I stated in the report for NAM, the key to this analysis is not in the overall direction of policy, but in the details. However, it is our belief that strong forces are at work to make sure that EC-92 is not being driven by a protectionist trade strategy, and that there will not be a general policy aimed at reducing exports from the United States to EuropeThis point is now generally accepted among most sources that have analyzed EC-92 proposals in detail. It is one conclusion of the overall study recently written by Data Resources Inc. (DRI), for example.

Many observers concerned about protectionism in the E.C. have jumped to the conclusion that because one major E.C. country demands protection, then some protection must be granted as the price of achieving an overall agreement. This, however, overlooks the impact of adoption of the Single European Act in 1987. By this amendment to the Rome Treaty, only in three areas - fiscal policy, social affairs, and mobility of persons within the E.C. - can one country prevent adoption of a policy agreed by other members of the Council of Ministers.

Also, any conclusion that EC-92 will turn protectionist also overlooks the struggles between different forces within the E.C. on this issue. For example, a recent comprehensive statement on this subject by the German industry confederation (BDI), clearly condemns any effort to adopt any policies aimed at establishing E.C.-wide quotas or trade rerstrictions, to replace those existing today at the national level as the internal market comes fully into effect. BDI concludes:

> A community that advocates free-market principles must also apply them externally; only then can it legitimately warn its trading partners to stick to the rules and demand that they bear a genuine share of the responsibility for avoiding tensions and disturbances in world trade.

This coincides with our conclusion at NAM, that if the E.C. is to become more globally competitive through EC-92, they cannot simultaneously adopt a protectionist trade strategy. We foresee a much higher degree of global market integration and reliance on use of non-EC technologies, not less, resulting from this process.

But all this does not mean that we should ignore the impact of restrictive or trade-distortive policies in specific areas. Our conclusion is that such policies may particularly affect the ability of U.S. companies to take advantage of market-liberalization initiatives in the public procurement sectors hitherto excluded from E.C. or GATT provisions. U.S. exporters may also be affected by E.C. anti-dumping and rule-of-origin policies not directly linked to the EC-92 program. This can especially happen if U.S. companies have switched to components made by Japanese or other East Asian companies in products which they export to the E.C.

On the whole, we do not expect such policies to offset the overall beneficial aspects of EC-92 for U.S. investors and exporters. But we have conveyed our concerns regarding such policies directly to the representatives of the European Community, to the executive branch agencies in the United States, and, in previous testimony, to Congress. And I would be pleased to discuss these concerns in more detail here. To sum up our position in this area, I would like to paraphrase a great European named Oliver Cromwell: "Put our trust in the E.C. - but keep our powder dry."

EC-92 and U.S. Industry

An NAM Report on the Major Issues for U.S. Manufacturers
in the European Community's Internal Market Program

by Stephen Cooney
Director, International Investment and Finance

NAM
National Association of Manufacturers
February 1989

The National Association of Manufacturers is a voluntary business association representing approximately 13,000 member companies and subsidiaries—large and small—located in every state. Members range in size from the very large to the more than 9,000 smaller manufacturing firms, each with fewer than 500 employees. NAM member companies employ 85 percent of all workers in manufacturing and produce more than 80 percent of the nation's manufactured goods. NAM is affiliated with an additional 158,000 businesses through its Associations Council and the National Industrial Council.

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FOREWORD

Over the past year, a new buzzword -- EC-92 -- has sprung up in our vocabulary. EC-92, of course, refers to the plans of the European Community to eliminate barriers to the completion of the E.C.-wide internal market by 1992. While the buzzword may be new, the work in the European Community to achieve this goal has been going on since 1985.

For U.S. manufacturers exporting to and operating in Europe, EC-92 is an extremely important issue. U.S. exports to the EC amount to $80 billion and intra-EC sales of U.S. firms in Europe total $550 billion annually. Two-thirds of the non-communist world's GNP is accounted for by the economies of the E.C. and the United States. What goes on within the E.C. market, therefore, has an important bearing on the interests of the rest of the world.

While NAM has been following this issue since 1985, it was not clear to us exactly how the interests of the American manufacturing community were affected by EC-92, despite the rather extensive amount of recent press coverage. We decided, therefore, to conduct an extensive series of discussions and interviews with government and corporate officials on both sides of the Atlantic with the aim of producing a report on what EC-92 means to the American manufacturing community. Stephen Cooney, Director for International Investment and Finance at NAM, has been in charge of this work over the past six months and the results of his efforts follow.

This report is intended to help identify the important issues for American manufacturers in EC-92. It is designed as an information document and not as an NAM policy statement. Development of NAM policy positions on specific EC-92 issues will be coordinated by an NAM Task Force on EC-92, chaired by Glen J. Skovholt, Director, Policy and Strategy for Corporate Public Affairs, Honeywell Inc.

We would encourage any comments and analysis on this NAM report and we would be glad to answer questions or hear comments about how EC-92 affects American manufacturing interests.

Howard Lewis III
Vice President, International
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National Association of Manufacturers

EC-92 AND U.S. INDUSTRY

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EC-92 AND U.S. INDUSTRY

EXECUTIVE SUMMARY

The plan to complete the opening of European Community internal market by 1992, known in shorthand as EC-92, promises to have major effects on U.S. industry. The overall view of U.S. industry is strongly positive. NAM members emphasize the positive impact of strong and dynamic growth, in an increasingly deregulated market.

This report aims to provide guidance for NAM members on the changing European business environment. It focuses on the specific issues and proposals related to EC-92 that have been identified as being of most concern to U.S. industry, rather than the overall history, politics and economics of the E.C. internal market program. The report is based on extensive consultations by the author with NAM member firms in the United States and Europe, cooperating business associations, and information provided by representatives of the U.S. government, staff of the European Commission in Brussels and officials of E.C. member-state governments and private trade associations.

This report is divided into two parts:

Part I: Evolution of EC-92 and U.S. Industry is an overview of both the interests of U.S. industry in EC-92 and the development of the EC-92 program. The major subjects of this part of the report are as follows.

What Is at Stake for U.S. Industry?

As indicated in NAM's recent comprehensive trade report, the E.C. may be the strongest and most important market from the perspective of increasing U.S. exports. The fall in the dollar, improved E.C. growth rates and the relatively open E.C. market has led directly to a three-year boost in the level of U.S. exports. The 1988 level was $27 billion higher than in 1985. This has also meant reducing our trade deficit with the E.C. from $24 billion to $12 billion, accounting for over a third of the total $33 billion improvement in the U.S. trade deficit in 1988. Moreover, the E.C. is far and away the most important host for U.S. manufacturing investment abroad -- at $65 billion, more than half the worldwide total.

The E.C. Internal Market Program

The basic thrust of EC-92 is to complete the internal market established as a European objective by the Treaty of Rome over 30 years ago. As laid out in the E.C.'s 1985 "white paper," this involves the pragmatic elimination of three major types of barriers.

-- **Physical barriers** at the borders to the free flow of goods and persons;

-- **Technical barriers** that prevent goods produced or traded in one member state from being sold in others;

-- **Fiscal barriers** such as the red tape, delays and costs of different national tax systems which prevent cross-border trade.

Also associated with the elimination of these barriers are major initiatives in related areas, including competition policy, encouragement of research and development, establishment of coordinated monetary policies with possible monetary union, and decisions on common social policies.

Prospects for Completing EC-92 and the Process of Adopting EC-92 Policies

The first part of the report reviews the major issues involved in the completion of the ambitious EC-92 program. It notes that whatever the outcome of these politically sensitive questions, which could prevent the goals of the 1985 White Paper from being fully achieved, many directives and policies related to 1992 will go into effect as they are approved by the E.C. The reappointment of President Jacques Delors for a second term as President of the European Commission, beginning in January 1989, indicates the strong commitment of E.C. member states to achievement of the internal market goal. During the term of the new commission, which ends on December 31, 1992, the conditions for U.S. companies of doing business in the E.C. will be changed in a major and irrevocable way.

The first part of the paper concludes with an analysis of how EC-92 policies are developed and adopted within the E.C. institutional framework. It also summarizes the ways in which U.S. companies can seek access to provide and receive information on how the process may affect their interests.

Part II: Major Issues for U.S. Companies in EC-92 reviews the major issues that could either enhance or reduce the opportunities for U.S. companies as investors in or exporters to the E.C. These major issues represent the subsections of Part II of the report. Within each subsection, the report analyzes the principal relevant proposals of the EC-92 program that have been adopted or considered to date.

1) **Technical and Environmental Standards** -- The harmonization of technical standards, a major part of EC-92, can have a major impact on current and future access of goods produced by U.S. companies for the E.C. market. The expedited adoption of common E.C. standards is widely seen by U.S. companies as a major benefit. However, there are serious concerns regarding timely and adequate access to standards information through the voluntary E.C. "CEN/CENELEC" standards-setting process. Also, U.S. companies have concerns regarding the implementation of E.C. certification and testing recognition procedures.

2) **Public Procurement** -- The enhancement of existing E.C. rules on the opening of member government procurement and the extension of E.C. rules to the sectors presently excluded from GATT or E.C. discipline are designed to increase dramatically cross-border procurement within the E.C. The new rules, at least in the previously excluded sectors, will not necessarily apply to non-E.C. source products. But the E.C. has indicated a willingness to consider open access on a reciprocal basis, either bilaterally or multilaterally.

NAM members have indicated concern with the new local content rules included in the proposals regarding procurement in the presently excluded sectors, but are encouraged by the principle of opening these markets within the E.C. and the commitment to negotiating opening of these sectors to other signatories of the GATT procurement code.

3) **Reciprocity** -- The controversial stated E.C. policy of extending intra-E.C. market opening initiatives to non-E.C. producers only insofar as E.C. trading partners provide equivalent access to their markets for E.C. producers has led to great public concern with the emergence of a "Fortress Europe" in world trade. The October 1988 Commission statement on the definition of reciprocity has alleviated some U.S. industry concerns regarding this subject.

4) **Sectoral Trade Issues** -- This report particularly focuses on the future development of E.C.-wide common commercial policies and other sectoral initiatives regarding automobiles, telecommunications and information technology, because of the broader implications of policies in these areas.

5) **Rules of Origin and Local Content** -- U.S. industry is strongly concerned with the development of E.C. rules that determine whether goods are of E.C. origin, not only for the application of specific trade benefits or penalties, but also on a more general basis regarding the treatment and access of foreign companies or producers in the E.C. market.

6) **Intellectual Property** -- Enhancement and completion of a Europe-wide system of protection of trademarks, patents and copyrights is a process that pre-dates EC-92. But it has been stimulated by plans to create a more integrated market. Generally, U.S. companies are supportive of proposals to allow registration in one member country to be valid for the whole Community, as well as to broaden the products that are covered by E.C.-wide copyright rules. There are concerns, however, with some proposed reform procedures.

7) **Social Dimension** -- The increase in unemployment in the E.C. between the early 1970s and the 1980s has been a major stimulus for the acceptance of the EC-92 program. The "social dimension" of EC-92 includes new initiatives in employment and social affairs related to the creation of a more integrated E.C. market. Both U.S. companies and E.C. industry generally have been supportive of proposals aimed at establishing E.C.-wide safety standards, reducing regional disparities, improving worker training and enhancing labor mobility. Concerns have been expressed over other initiatives, that would have the effect of establishing more rigid E.C.-wide industrial relations policies and practices.

8) **Competition Policy** -- Establishment of E.C.-level control over mergers and acquisitions, particularly large-scale multinational combinations, is seen by U.S. companies as potentially providing an expedited means of increasing E.C.-wide competition, while producing substantial gains for the E.C. through improved economies of scale.

9) **Monetary Policy** -- The E.C. has already agreed on the elimination of all controls on capital movements within the E.C. Currently under consideration are the establishment of mandatory coordination of monetary policies and possible creation of a single E.C. central

bank and currency. These policies not only enhance the ability of U.S. companies to operate within the E.C. framework, but may also have a major impact on the E.C.'s international competitive status.

10) **Potential Issues** -- The report concludes by noting two other issues not now included in the EC-92 program, but which may have a major effect on U.S. companies when they are considered by the E.C. in the future. These are future rules regarding the opening of defense procurement within the E.C. and the adoption of common E.C.-wide export control policies.

EC-92 AND U.S. INDUSTRY

An NAM Report on the Major Issues for U.S. Manufacturers in the European Community's Internal Market Program

by
Stephen Cooney
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National Association of Manufacturers

February 1989

INTRODUCTION

There is no hotter subject among U.S. business leaders than the proposal to eliminate the European Community's remaining internal market barriers by 1992. Virtually every U.S. industry and major company now is trying to understand what "EC-92" means for them and for their world marketing strategies.

At this point, U.S. companies almost uniformly emphasize that EC-92 represents a major market opportunity. They see the proposed package as contributing both to a rapid expansion of the E.C. market and, in practice, to a deregulation of that market which will increase opportunities for competitive producers. Within this overall positive outlook, however, there are a series of major policy issues, the outcome of which could either enhance or reduce business opportunities for U.S.-based exporters or U.S.-owned companies already established within the E.C.

This report aims to provide guidance for NAM members on the changing European business environment. It focuses on the specific issues and proposals related to EC-92 that have been identified as being of most concern to U.S. industry, rather than the overall history, politics and economics of the E.C. internal market program. The report is based on extensive consultations by the author with NAM member firms in the United States and Europe, as well as cooperating business associations. The firms consulted in Europe include European as well as American-owned enterprises. The report is also based on information provided by representatives of the U.S. government, staff of the European Commission in Brussels and officials of E.C. member-state governments and private trade associations. The report is not a formal NAM policy statement on EC-92 issues, though it may indicate those issues in EC-92 on which NAM policy may later be developed.

The following issues are those that have been identified as being of greatest importance to American industrial exporters and investors doing business in the E.C. Each is given a separate detailed section in Part II of the report, where the most critical specific proposals and policy choices are discussed.

1) Technical and Environmental Standards
2) Public Procurement
3) Reciprocity
4) Sectoral Issues
5) Rules of Origin and Local Content
6) Intellectual Property
7) Social Dimension
8) Competition Policy
9) Monetary Policy
10) Other Potential Issues

This report refers to many texts of specific documents and policy proposals related to these issues. Precise references are provided in the report for the use of members who wish to follow up on issues in more detail. In many cases these proposals will evolve as they move through the E.C. policy process. Listed at the end of the report are some contacts in the United States and Europe which are good sources of information for U.S. companies as they seek information on the issues of most importance to them.

Organization of this Report

This report is written in two parts. The first part is a general orientation for the business reader. It summarizes the importance of the E.C. market for U.S. business, then briefly describes the development of the EC-92 proposal and the policy processes of the European Community as amended by the Single European Act of 1987 (SEA). This latter constitutional change is so named because the E.C. member states used one negotiated instrument to amend the basic European Coal and Steel Community and Euratom treaties, as well as the Treaty of Rome that established the Common Market.

The second part of the report is based on a "watch list" of major EC-92 policy issues, whose development will be critical for the future role of U.S. business in Europe. These are not necessarily the most important or visible EC-92 issues from the member states' own political and economic perspectives, but may be the ones with the most impact on U.S. business and manufacturing interests. Accordingly, this is the range of issues which will receive most attention from NAM during the evolution of EC-92.

I. THE EVOLUTION OF EC-92 AND U.S. INDUSTRY

What Is at Stake for U.S. Industry?

Many commentators in recent years have criticized U.S. business for being too "Euro-centric," too focused on traditional and slow-growing markets in western Europe. We have been told that the future, high-growth markets are in such areas as the Pacific Basin, Latin America and other less-developed economic regions, or even the major Communist countries. These analyses underestimate the dynamism, openness and growth possibilities that remain in Europe. While U.S. exporters should seek markets wherever they can find them, for the foreseeable future the E.C. may remain the key growth market overseas for U.S. industrial companies.

Europe is our most important regional export market, and will remain so indefinitely. The value of U.S. exports to the European Community is about a quarter of total exports, a little higher then the share going to Canada. But a quarter of all U.S. exports to Canada are cars and parts involved in the two-way auto trade agreement. As for other countries and regions, Japan takes only 8 percent of our exports and the rest of East Asia another 13 percent. All of Latin America takes only 13 percent. And most importantly, no other regional market approaches the level of economic integration found in Europe today, much less what is being contemplated by 1992.

The E.C. is a critical market for many specific U.S. exports. In 1988, 46 percent of all U.S. exports of computers and parts have gone to the E.C. -- that's a projected total of over $10 billion in exports of that product to the European Community. The E.C. is also the largest market for U.S. electrical machinery and parts, a category that includes semiconductors. Total U.S. exports to the E.C. in 1988 may have hit $4.5 billion. The E.C. takes about a third of U.S. aircraft exports, with sales this year running over $6 billion at an annual rate. And in scientific and controlling instruments, where U.S. manufacturers maintain a strong trade surplus, 35 percent of all exports in 1988 went to the E.C.

The E.C. market has been the most important one so far in turning around the U.S. trade deficit. The fall of the dollar has had a bigger and faster impact on growth in exports to Europe than any other region. U.S. export growth to Europe has been near or above double figures since 1985 and has been accelerating -- 9 percent in 1986, 14 percent in 1987 and an incredible 25 percent in 1988. Since 1985 the increase in our exports to the EC. from $49 billion to $76 billion in 1988, has been roughly equal to our total exports to Japan in 1987. It's as if we have suddenly found a new export market out there the size of Japan. This export growth in 1988 cut the annual rate of the bilateral U.S. trade deficit with the E.C. in half: from $24 billion in 1987, to $12 billion in 1988. That change alone accounted for more than a third of the total improvement of the U.S. trade deficit in 1988.

Finally, let's look at investment. The total U.S. direct investment stake in the European Community is nearly $125 billion, according to official statistics. In manufacturing investment alone, total U.S. holdings in the E.C. were valued at $65 billion at the end of 1987 -- more than half the total value of U.S. companies' manufacturing investment abroad. It is more than double the amount in Canada, almost ten times the amount in Japan, four times the total for all Latin America and twelve times the total for all Asia outside Japan.

The E.C. Internal Market Program

Anything that affects U.S. economic interests on this scale is obviously of critical importance to U.S. industry and to the U.S. economy more generally. The E.C. internal market proposal -- the goal of completing the internal E.C. market and removing all intra-E.C. trade barriers by 1992 -- is probably the most important policy initiative taken within the European Community since the founding of the Common Market in 1957. This explains the extraordinary interest of U.S. business in this initiative.

It is the very failure to complete the common market as originally envisioned that has led to the development of EC-92. For example, as one American executive with extensive experience in the E.C. has explained, "On January 1, 1958, the original six members of the Common Market took down their signs at the internal borders that said 'Customs.' Then they put up new signs that said 'Taxes.'"

What he means is that differences in internal national regulations -- and not just taxes, but in other areas like technical standards and public procurement policies -- have circumscribed the benefits of a truly open and free market among the Common Market's members. As the European Community doubled in members, this problem has not become any simpler to resolve. Cross-border controls remain in place for a plethora of reasons. According to the European Commission's official study, summarized in the report The European Challenge - 1992 by Paolo Cecchini, the resulting "cost of non-Europe" may equal 3 to 6 percent of Europe's gross domestic product, or a total of $250 billion annually.

These costs were tolerable in the 1950s and '60s as the European economies boomed. There was visible progress in the initial elimination of national tariff barriers within Europe. American companies contributed to this progress by investing heavily and by bringing in their expertise in operating across a wide range of regional markets. But the initial momentum and optimism faded in the 1970s, with the energy and unemployment crises in Europe, a major growth slowdown, stagflation and the European version of the U.S. "malaise" of the late 1970s: "Eurosclerosis."

The proposal to establish a fully open internal market by 1992 is designed to sweep away the de facto obstructions to free trade within Europe. To understand the genesis of the proposal, which dates from 1985, it is necessary to understand the failures of previous efforts to eliminate internal market barriers by harmonizing national product standards and other policies. There were efforts to define specific E.C.-wide codes for goods on a product-by-product basis -- Euro-beer, Euro-bread, Euro-ice cream and so on. Progress was so slow, that it could not even keep pace with the development of new products in the dynamic European economy.

Finally, in a landmark decision the European Court of Justice declared that member governments could not use their national standards and regulations as a basis for keeping out goods that were legitimately sold and consumed in other member countries. This decision -- the Cassis de Dijon decision -- meant that E.C. member countries had to accept some expeditious means of developing E.C.-wide minimum product standards. The alternative would be goods sold in their national markets that were produced under conflicting standards or even no standard at all.

Another impetus behind EC-92 was world competitiveness. The goal of a "United States of Europe," going all the way back to Jean Monnet, the father of the European idea, was always outward-looking as well as inward-looking. Monnet wanted Europe to be a power in world economic and political affairs. By the early 1980s, it had become clear that market barriers within Europe were inhibiting the development of economies of scale sufficient to make European-based enterprises competitive in the world economy.

We also cannot forget the employment question as a major impetus for change. Unemployment rates in Europe mounted and remained stubbornly high in the early 1980s. From essentially full employment, or even "negative unemployment" in some E.C. member countries around 1970, the total estimated E.C. unemployment rate rose through the 1970s and reached double digits, 10.5 percent, in 1983. Since then, it has not appreciably fallen. It became increasingly clear to E.C. members that it was necessary to add a new structural dynamic at the Europe-wide level, and that addressing the unemployment problem solely at the national level of structural adjustment provided an insufficient solution to national unemployment problems.

The Cecchini report estimates that the total growth in E.C. GDP as a result of elimination of internal market barriers would directly create 1.8 million new jobs. This would not solve the E.C. unemployment problem, though it would at least reduce unemployment by an estimated 1.5 percent, allowing for some initial job losses due to restructuring. More importantly, as with world competitiveness, there was a perceived need to create a solution to the unemployment problem that was on a greater scale than provided within the individual member country economies. This need was compounded by the great disparities in regional development within the E.C., especially after the addition of the three lower-income Mediterranean countries in 1981-86.

In 1985 the recently-appointed European Commissioner for the Internal Market, Lord Cockfield of the United Kingdom, produced a remarkable new proposal which has revitalized the European Community. Backed by the recent decision of the European Court of Justice, the Cockfield "White Paper" proposed a target list of about 300 directives and other policy actions, aimed at eliminating effective barriers to the internal market. Taken together, these directives would:

-- Eliminate all remaining physical barriers to the movement of persons and goods within the E.C.;

-- Eliminate differences in national technical standards as barriers to the free movement of goods;

-- Eliminate national differences in indirect tax rates as a trade barrier.

Moreover, Lord Cockfield insisted that the package was a package. It had to be achieved by a date certain -- 1992 -- or the whole process would be blocked by each member-state picking the benefits they wanted, and dragging their feet on the rest. Cockfield's program was both encouraged and fully backed by the European Commission President, Jacques Delors, who has made EC-92 his top priority. In addition, the Single European Act (SEA), specifically approved to expedite completion of the internal market, established that most internal market directives would be adopted by qualified majorities. No one member government could block directives by withholding its consent.

Prospects for Completing EC-92

EC-92 is a moving target. But this is a good halfway point at which to assess developments. Nearly half of the proposed list of directives in the 1985 White Paper have already been adopted or advanced to the final stages of approval. Due to differences with Prime Minister Margaret Thatcher over the speed of certain aspects of EC-92, Lord Cockfield has not been re-nominated to the Commission by the British government. But the reappointment of Delors as President, for the new term starting in 1989, signifies that the process will continue, with the support of the E.C. member states.

The most serious political obstacles to achievement of the EC-92 package do not necessarily involve the most salient operational issues for U.S. companies. This is important for NAM members to remember as they follow the progress of the EC-92 program. Perhaps the most difficult decisions that the E.C. will have to make on the EC-92 agenda involve U.S. interests and U.S.-E.C. economic relations only indirectly, insofar as U.S. companies and the U.S. economy as a whole have a major stake in the successful completion of the EC-92 program. Such issues include:

-- Harmonization of VAT rates;

-- Complete elimination of frontier controls on movement of persons within the E.C.;

-- Monetary policy harmonization, including the possible establishment of an E.C. central bank and single currency.

Whatever the outcome of these politically sensitive questions, which could prevent the goals of the 1985 White Paper from being fully achieved, other directives and policies related to 1992 will go into effect as they are approved by the E.C. In this sense, Lord Cockfield's admonition that EC-92 must be achieved as a complete package is misleading: those parts of the package that attain final approval will immediately begin to affect how business is done in Europe. Moreover, some European economists dispute the conclusions of the Cecchini study regarding patterns of growth. The study predicts some loss of economic growth due to restructuring problems as EC-92 begins to affect E.C. economies, followed by large gains in the mid-1990s. But other economists see more "front-loaded" growth due to new efficiencies as parts of the EC-92 package enter into effect.

On January 1, 1989, a new Commission took office in Brussels. President Delors was reappointed, but there were many important changes in the other portfolios (an updated list of the Commissioners is provided in an appendix to this report). U.S. companies should at least anticipate that a large part of the total EC-92 package will be in place by the end of this Commission's mandate in four years. During this period, the conditions for U.S. companies of doing business in the E.C. will be changed in a major and irrevocable way.

The Process of Adopting EC-92 Policies

Before analyzing in detail the major issues of EC-92 for U.S. companies, it is important that the reader have a general familiarity with European Community terms and institutions. Moreover, the fundamental relationship of the member states and organs of the E.C. has been altered by adoption of the SEA in 1987, specifically to enhance completion of the internal market. General background knowledge of the institutional relationships within the E.C. is necessary for determining the most appropriate points in the process for U.S. companies to raise questions or concerns regarding specific EC-92 proposals.

Most of the Internal Market legislative work will be carried out by three E.C. institutions: the European Commission, the Council of Ministers, and the European Parliament. These three institutions are responsible for proposing, debating and adopting Community legislation. In addition, the European Court of Justice decides on the legality of challenged E.C. legislative measures.

The Commission is responsible for formulating and proposing legislation and providing for the administration of Community policies. The Commission is led by 17 Commissioners (two each from France, the Federal Republic of Germany, Italy, Spain, and the United Kingdom, and one from each of the other member states.)

The Commissioners and their staff draft all Community legislative proposals and policy statements. Each Commissioner is responsible for one or more areas of Community policy, such as economic affairs, agriculture, environment and energy. The staff of the Commission are organized into directorates-general (DGs) -- there are 22 DGs at present, and they do not correspond exactly to the portfolios held by individual commissioners (see list in Appendix 1). The Commissioner responsible for the Internal Market program in the new Commission is Martin Bangemann, formerly Economics Minister of Germany. DG III is the directorate responsible for many internal market policies, but other directorates also have relevant areas of authority.

Once E.C. legislation is adopted, the Commission is responsible for implementation. If legislation is adopted in the form of a regulation, it immediately becomes law in the member state. However, most EC-92 policies are cast in the form of directives, which means that each member government must pass or have previously established national legislation conforming to the general terms of the E.C. policy. The Commission is also the executive body responsible for negotiations with non-E.C. countries and organizations in areas where member states have ceded authority to the E.C. -- notably trade policy. These contacts are handled primarily through DG I (External Relations), though other directorates are involved in some specific functional issues.

The **Council of Ministers** is the decision-making body of the Community and must approve all Community legislation. It is the only Community organization whose members act as representatives of the individual E.C. member state governments. Member governments are represented at Council meetings by the national minister who has responsibility for the subject under discussion. The presidency of the Council rotates every six months, in accordance with the "E.C. alphabet:" the alphabetical order of member state names in their respective national languages. Thus, Germany (Deutschland) and Greece (Ellas) chaired the Council in 1988, to be followed by Spain (Espana) and France in 1989. This rotation is quite important, because the national government's own priorities can heavily influence the Council agenda during its presidency.

Formerly, the Council could only take decisions on most important matters by unanimous agreement. The SEA has amended the Treaty of Rome to allow Council approval on most internal market proposals by "qualified majority" voting. This change may prove extremely important to U.S. companies, who will no longer be able to rely on one country to block changes that may disadvantage them and who correspondingly may be less concerned about individual countries that oppose favorable internal market reforms. Appendix II explains the qualified majority voting rules. Note that not even two large countries voting together or any combination of one large country and two small ones can block an internal market proposal. In certain areas, such as 1992 measures, the Council must also formally consult with the European Parliament and the Economic and Social Committee.

The **European Parliament** (EP) is comprised of 518 members, directly elected by the voters in each of the member states, roughly in proportion to the member state's population. The Members of the European Parliament (MEPs) sit in nine political party groupings, such as the Socialist Group or the European People's Party, rather than in national groups. At present, the Socialists have the largest single voting bloc within the EP, augmented by a substantial number of Communist MEPs and members of other left-wing groups. Since 1979, the EP has been directly elected by voters in the member states. The next EP election is set for this year.

The EP advises the Commission and the Council on legislative proposals before any legislation is adopted. It also exercises a measure of democratic control over the Commission and the Council through its right to amend or delay legislation. This power has been increased under the SEA, especially with regard to EC-92 issues. Specifically, the EP may amend Commission proposals, then reapprove their amended version by a two-thirds majority, if the Commission does not accept the EP amendments. The Council may subsequently only reject the EP version and replace it with its own through a unanimous vote. The EP also must approve the E.C. budget, and, importantly for U.S. interests, must ratify all E.C. treaties with non-member countries.

The **Court of Justice** (ECJ) is comprised of thirteen Judges and six Advocate-Generals, each appointed by agreement among the national governments for six-year terms. As the "Supreme Court" of the Community, the ECJ determines the validity and correct interpretation of challenged Community law provisions. A new Court of First Instance has also been established to relieve the backlog of cases awaiting decision by the ECJ.

The ECJ does not have a role in legislating individual 1992 laws as do the other three Community institutions described above. Through its legal decisions, however, it has been a driving force behind European integration generally and in several instances has forced the Member States to eliminate barriers to free trade within the Community, as noted above in the Cassis de Dijon decision, and confirmed by recent decisions regarding Italian pasta regulations, the German beer purity law and the Danish bottle law. Individuals and companies may challenge E.C. or member state policies directly in the ECJ. This is different, for example, to the GATT, where only member governments may lodge complaints against each other.

The institutional structure of the E.C. provides U.S. companies with a number of points of access to voice their concerns and opinions on EC-92 proposals:

-- Specialists within the relevant directorate of the European Commission;

-- Member state trade and industry associations, as well as the E.C.-wide employers' association (UNICE), headquartered in Brussels;

-- Functional ministries of national governments in sympathetic member states;

-- Member states' permanent delegations to the E.C., who do most of the background work for the Council of Ministers' meetings through the Committee of Permanent Representatives (COREPER);

-- Members of the European Parliament who may be sympathetic to the position of the U.S. company;

-- National E.C. member state legislatures, which must enact all EC-92 directives into specific laws.

Also, it is very important that U.S. companies should remember contacts with relevant U.S. government representatives in Washington and Brussels -- general contacts are listed at the end of this report.

II. MAJOR ISSUES FOR U.S. COMPANIES IN EC-92

1. TECHNICAL AND ENVIRONMENTAL STANDARDS

One of the major components of the internal market is the elimination of differences in technical standards, that serve as barriers to intra-E.C. trade. The issues associated with the elimination of technical standards barriers within the E.C. and the establishment of a new E.C.-wide standards process may affect more U.S. companies than any other EC-92 issue.

In view of the Cassis de Dijon decision and the Internal Market program, a wide range of technical "framework" standards are being negotiated. Community policies will put particular emphasis on certain sectors, including information technology and telecommunications, pharmaceuticals, chemicals, medical products, construction equipment and food products.

From the U.S. perspective, it should be understood from the outset that the reform of the technical standards process in the E.C. is not intended as a market-opening device with respect to non-E.C. trade partners. E.C. documents indicate that the E.C. will remain bound by existing GATT obligations related to technical standards. But the E.C. has undertaken no commitment to widen opportunities or to eliminate existing standards conformance problems for producers outside the E.C. as part of the 1992 process.

Nevertheless, the harmonization of technical standards can potentially create substantial benefits for U.S. companies -- even those operating outside the E.C. itself. Under EC-92, U.S. companies at most will need to obtain certification from only one E.C. authority for the product to be considered as duly acceptable throughout the E.C. market. In some cases, the continuation or renewal of existing international mutual recognition agreements may even mean that normal U.S. certification procedures will also allow products to be certified for use or sale throughout the E.C. But typically such agreements only exist for a limited range of products, and it is unclear how rapidly mutual recognition agreements will be developed under the new E.C. system. And the negotiation of new standards for testing procedures allow scope for the "harmonizing up" of standards to a degree that U.S. producers consider unreasonable, unnecessary or even anti-competitive with regard to world market sales.

The New E.C. Approach to Standardization

Beginning in 1983, the E.C. developed a new approach to product standardization and harmonization, which has been incorporated into the internal market concept. As succinctly summarized in Ernst & Whinney's August 1988 report Europe 1992: The Single Market, "Any product which can be sold in the member state in which it is produced will be freely marketable in other parts of the E.C., unimpeded by diverse national standards or testing and certification practices." The emphasis in this approach is on "mutual recognition and equivalence," as opposed to negotiation of detailed manufacturing and process standards. There are three main ways of introducing this new approach:

-- A 1983 directive prohibited member states from creating new technical standards through regulations that would serve as market barriers between E.C. countries;

-- A new E.C. standardization procedure was created through the New Approach to Technical Harmonization, formally agreed in 1985;

-- E.C. governments will be required to accept agreed guidelines for standards and procedures in testing laboratories. This will mean results from other E.C. countries' certifying laboratories will be accepted by all E.C. countries.

Within this approach, there is a strong distinction between "standards" (defined as voluntary specifications) and "technical regulations" (mandatory requirements imposed by law). The E.C. framework directives deal with technical regulations, where necessary, by setting essential requirements for the E.C. as a whole. The E.C. is also promoting voluntary standardization at the E.C. level, not only for the purpose of fulfilling the legislative goal of mutual recognition and equivalence, but also because common standards in general make economic sense.

How will the Community implement this approach? The basic directives are relatively general. The key question will be how they are to be translated into specific product standards recognized and accepted across the E.C. And while the emphasis may be on mutual recognition and equivalence, these evolving E.C.-wide safety and product standards may affect the manufacturing and application of covered products. For setting industry standards, the E.C. has adopted the approach of reliance on existing private Europe-wide standards institutes for general and electrical products (known by their combined abbreviations as CEN/CENELEC).

The enhanced mandate provided CEN/CENELEC by the E.C., and how this body interacts with the national standards organizations, particularly DIN (Germany), BSI (U.K.) and Afnor (France) are described in detail in the European Commission publication Common Standards for Enterprises (written by Florence Nicolas of Afnor, and published in August 1988). This booklet should be required reading for U.S. companies concerned with CEN/CENELEC, so that they understand the formal rules of the system. The goal, as expressed in this document, is that the process should develop in a transparent manner.

It is, however, far from certain that the development and implementation of standards will be as transparent as either the European Commission or U.S. industry might hope. There are serious concerns among some industries, particularly some U.S. exporters, that the process will not allow non-European comment at a sufficiently early stage to prevent the development of E.C.-wide standards as a trade barrier. An excellent brief summary of this process from the U.S. perspective, which also discusses this concern, has been written by Patrick Cooke and Donald Mackay of the National Bureau of Standards in the article "The New EC Approach to Harmonization of Standards and Certification." It was published in the Commerce Department's bi-weekly magazine, Business America on August 1, 1988, and is appended to this report.

In principle, the adoption of common standards is widely seen by U.S. companies in Europe as a major benefit. U.S. companies with production facilities in Europe believe that they will be able to rationalize production across national frontiers to a much greater degree than at present. This process will be facilitated for companies heavily reliant on road transportation by accompanying liberalization of national rules related to domestic and international trucking. U.S. exporters may achieve comparable benefits. Whatever standard is adopted for a product, the potential U.S. exporter will be assured that complying with this standard provides access to the entire E.C. market.

Despite these potential benefits, there are serious concerns that some European companies with rigid standards currently in place in their home national market will seek to protect and strengthen their E.C. market position by "harmonizing up." That means having the E.C. adopt their own national standards on an E.C.-wide basis. Such an approach would, of course, defeat the purpose of "mutual recognition and equivalence." The need to achieve consensus within the CEN/CENELEC process mitigates against such outcomes, but at present there is a high degree of uncertainty among companies about how the consensus-building process will work in practice.

There are four ways by which U.S. companies can counteract the problem of "harmonizing up" in the E.C. standards-setting process:

-- U.S. companies operating in Europe should participate fully in national and E.C.-wide standards bodies that will have access to the EC-92 standards process. This may be the only way that U.S. companies can obtain access to the standards process during the initial development phase. As non-E.C. producers may be excluded from the early (and crucial) stages of the CEN/CENELEC standard-setting process, it will be important at this stage to identify distributors and potential E.C. production partners who can serve as effective supporters of the U.S. company's position.

-- The E.C. requires CEN/CENELEC to adopt existing International Standards Organization (ISO) or International Electrotechnical Commission (IEC) standards where they exist and are appropriate. U.S. companies should insure that they are familiar with ISO/IEC standards and are prepared to implement them for products sold in Europe. But it should also be recognized that relatively few ISO standards have been developed in many product areas. Recent comments by the CEN/CENELEC chairmen indicate that this latter problem may be alleviated by trying to develop new standards initially at the ISO/IEC level, rather than starting at the E.C. level.

-- All draft CEN/CENELEC standards and specifications are now supposed to be circulated to the American National Standards Institute (ANSI) before final adoption. Concerned U.S. companies should contact ANSI for information on proposed product standards of relevance to them.

Some U.S. companies and industry associations have said that ANSI receives drafts too late in the CEN/CENELEC process to allow timely comment by non-European companies. U.S. companies should indicate to both their E.C.

contacts and U.S. government contacts if such notice is not timely enough to allow for U.S. reaction and input. CEN/CENELEC may reduce this problem through a new monthly publication listing all upcoming product standards projects.

-- In developing U.S. national standards and in participating in worldwide standards bodies, U.S. companies should seek to ensure a maximum level of conformity between international norms and national standards in Europe, North America and Asia.

One final and important note should be added on the development of standards. U.S. companies should expect a general process of upwards harmonization particularly with respect to E.C. environmental standards. Environmental concerns are now of major political importance in the E.C. This is reflected in the addition of an environmental title to the Treaty of Rome by the SEA. And Article 100a.3 now provides that "The Commission in its [internal market] proposals...concerning health, safety, environmental protection and consumer protection, will take as a base a high level of protection."

Certification and Testing

Another important question regarding the impact of new E.C. standards procedures involves the mutual recognition and equivalence of testing procedures and results. A draft November 1988 European Commission policy statement on technical specifications, testing and certification provides some clues as to E.C. plans.

The first basic question posed in the draft paper is to what degree and for what products will the E.C. require third-party testing and certification, as opposed to self-certification? The November draft paper indicates that the basic rule could be that self-certification will be applied when product design conforms to an established E.C. design standard. But "when...such standards do not exist," the paper continues, "or ..the manufacturer...prefers to apply other manufacturing criteria of his own choice, the demonstration of conformity to the essential requirements should involve the intervention of a third party, either by certification or by independent third party testing."

This approach could have major implications for U.S.-based producers that provide products that probably meet essential E.C. health or safety requirements, but do not necessarily meet specific E.C. design or testing criteria. The issue has been explained thus by a U.S. chemical manufacturer:

> What is of primary concern is that the Directives and Standards flowing from those directives may either ban products for sale in the E.C....or may establish test protocols that are entirely different from those performed in the United States and would require certification that the product has been tested in accordance with these protocols...The concern on the part of U.S. chemical exporters would be the expense of running the new tests and the time lost [of]...2-5 years...This would effectively keep somebody out of the marketplace until the tests had been completed.

To address this type of problem in the past, bilateral agreements have been developed between U.S. and E.C. national or multinational standards authorities on mutual recognition of certification of products or processes. But such agreements cover relatively few products, and only some E.C. member countries. Moreover, in some cases even these bilateral agreements could be nullified by the draft proposal under consideration in the Commission.

However, the Commission's draft statement devotes little time to this important issue. It states that non-E.C. origin products will have non-discriminatory access to E.C. conformity assessment procedures under terms of the GATT Standards Code. But it also notes that the GATT "does not lay down binding obligations...[regarding] participation by foreign testing and certification bodies in mutual recognition arrangements." The paper takes note of existing bilateral arrangements only with the EFTA countries. Otherwise, it considers only the future negotiation of such recognition agreements at the E.C. regional level. The paper does state that in all areas subject to either E.C. or national legislation, no bilateral agreements by member states with non-E.C. countries are allowed, "as such agreements confer easier access for third countries to the common market, which is a matter of common commercial policy under Article 113 of the [Rome] Treaty."

In summary, the E.C. attitude to international mutual recognition agreements will depend on whether products are subject to legislated regulations. If they are, mutual recognition agreements will have to be concluded by the E.C. and bilateral agreements will have to be renegotiated. Otherwise, the issue will be a matter for the private sector, and existing bilateral international agreements will be of no direct concern -- they will be neither enforced nor nullified by the E.C.

The conditions for negotiating future E.C. bilateral recognition arrangements with non-E.C. trading partners are summarized in the November draft statement as follows:

- The E.C. must be assured of the technical competence of the non-E.C. partner;

- The agreement must secure reciprocal benefits;

- Participation in the agreements is limited only to testing and certification bodies actually conducting the tests or issuing the certificates.

Even receiving the new "CE" mark may still not be enough to assure a company that its product will have clear sailing throughout the E.C. market. Concerns have been expressed in Europe that only products meeting national standards criteria and receiving national standards body labels can still be sold in some markets. For example, insurability rules can be used to keep out products not meeting a specified national standard. To ensure adequate preparation for the EC-92 market, U.S. companies should now identify obstacles related to the national application and use of standards that may inhibit E.C.-wide distribution of even those products that conform to new E.C.-wide standards. Then the next step will be to identify potential E.C. and U.S. support for the elimination of such effective barriers.

2. PUBLIC PROCUREMENT

One of the most far-reaching proposals in the 1985 internal market package dealt with public procurement. The Cecchini report on the economic cost of "non-Europe" calculates that public sector purchasing is equal to 15 percent of the Community's total gross domestic product, or a total of about $600 billion. Currently, just 0.14 percent of GDP, or less than $1 billion worth of goods and services, is purchased from E.C. companies outside the purchasing country's national territory. This shocking statistic lies behind the Commission's drive to open national public sector procurement markets to intra-E.C. competition.

While E.C. directives on public works and supply contracts are currently in force, these are generally perceived as weak and ineffective. Completing the internal market will require government procurement to be based on fair competition as opposed to national identity. This process is effectively to be completed in two steps:

1) Improving existing directives on public works and public supply contracts. The new public supply contracts directive was approved in final form by the Council of Ministers on March 22, 1988 (Directive 88/295/EEC). An amended proposed directive on public works contract procedures was submitted to the Council of Ministers on June 21, 1988, following receipt of proposed amendments from the EP. The Council has adopted a "common position" on this draft directive, indicating general agreement on substance, and the directive should be approved in final form within the next year.

These two directives work in a similar way. The bidding process in each country must be made completely transparent, with the elimination of single-bid or no-bid contracts without adequate public notice. This will be achieved by changes in contract notification procedures. In addition, the legal powers of the Commission to nullify contract awards will be strengthened. It is anticipated that in most cases these powers will be used on an advisory basis with respect to member state governments, before actual contract awards are made.

2) More controversy has been aroused by the other major initiative, the proposed extension of open public procurement rules to previously excluded sectors -- telecommunications, water, energy and transport. The Commission's formal proposals in this area have only recently been announced, in three documents issued on October 11, 1988:

-- Proposed directive on procurement procedures of entities providing water, energy and transport services;

-- Proposed directive on procurement procedures in the telecommunications sector;

-- Communication explaining the Commission's policy proposals in these two areas.

The most important point for U.S. companies is that these proposals create no new rights of access to the E.C. public sector market for products made outside the E.C. The Commission notes in parts II.D and III.F of the October 1988 communication that these sectors are generally excluded from the E.C.'s GATT obligations, therefore, "...Contracting entities are placed under no obligation to apply the provisions of the Directives to offers having their origin outside the Community."

To determine whether a product is covered by these proposed directives, the Commission proposes a 50 percent "local content" test: "...An offer is considered having its origin outside the Community when more than half its value represents goods or services produced or performed outside the Community." This local content rule is subsequently ameliorated for companies with investments in Europe by a broad definition of what may be included as local content: "...In the case of offers from subsidiaries or agents, a substantial part of the value of the offer may represent economic activity within Member States, and can thus be considered of Community origin."

The proposed directives also would create a positive requirement to discriminate in favor of E.C. suppliers over non-E.C. source suppliers, when the cost difference is 3 percent or less of the contract value. There is no sliding scale, so that a 50-percent E.C. content proposal, for example, is just as "European" as an 80-percent E.C. content proposal.

The justification for these actions that frankly discriminate against foreign trade is that the primary beneficiaries of EC-92 should be industry in the E.C. The Commission states that, "First, provisions are needed to defend the Community's commercial interests and preserve its negotiating position by making no unilateral concession but on the contrary creating a positive incentive for third countries to give guarantees of equal access to similar markets." The 50 percent E.C. content threshold and the contract bid margin have obvious precedents in U.S. "Buy-American" legislation. "Second," the Commission paper continues, "Community producers should, where necessary, be given the necessary time for the industrial adaptation required to meet the objectives of 1992 and the day when reciprocal access is finally agreed."

Thus the local content rule on public procurement in the excluded sectors is part of a strategy not just to protect E.C.-based producers, but also to force open public procurement markets internationally. The Commission is also seeking the power for itself and the Council of Ministers to grant other countries access on equal terms to public procurement in the excluded sectors, upon reaching agreement "through bilateral or multilateral negotiations" assuring equal access for E.C. producers in the trading partners' markets. But since it is not clear how successful this strategy will be, the proposed Commission policies will in the meantime perform the second task, that of "providing necessary time for industrial adaptation," or, in other words, protection for developing and restructuring industries.

Insofar as the GATT is concerned, the primary focus of such negotiations would not be the Uruguay Round, in the Commission's view, but rather negotiations among present GATT Procurement Code signatories on expansion of the code. This would have the advantage of including only countries that have already accepted the principles of such a code. It would notably exclude the less-developed countries. Of course, progress in the Procurement Code could always become part of an overall GATT package that includes the Uruguay Round results. The question of trade reciprocity and EC-92 will be discussed in a broader context in the next section.

Until any reciprocal access agreements are negotiated, the E.C. policy might also be construed as conflicting with the telecommunications provisions of the U.S. Omnibus Trade Act of 1988 (Secs. 1371-1382). This subject will be examined under the telecommunications heading in Section 5 below.

There are two other features of the procurement directives for the excluded sectors which should not be overlooked by companies:

-- First, the directives require that specifications in a contract must be in conformity with existing European standards, except that an indefinite waiver is provided when the contracting authority can show incompatibility with existing national systems and equipment or "disproportionate cost" in effecting a changeover to E.C. standards in the contract. The Commission staff's present expectation is for any such protection to diminish rapidly, to disappear in three to five years.

-- Secondly, the procurement directives in the excluded sectors do not apply to public purchasing authorities *per se*, but rather to monopoly providers of public services in a country or region -- whether these suppliers are themselves publicly or privately owned. Thus, for example, British Telecom (private) is included as a "contracting entity" as well as the publicly-owned Deutsche Bundespost network or the French PTT. This provision broadens the definition of public procurement, in an era of the privatization of publicly-owned monopoly entities.

This point also could have negative consequences for U.S. companies, depending on the E.C.'s interpretation of the concept of reciprocity of market access. Access to contracts for publicly-owned telecommunications or power projects in the E.C. would depend on the E.C.'s interpretation that their companies (whether in Europe or the United States) had equivalent access to such contracts in the United States, even if most of these contracts are privately let. For example, one large European-owned telecommunications company provided the opinion that such U.S. entities were indeed already open to E.C. equipment sellers to the degree envisioned in these directives -- but another company emphatically held that they were not.

The initial prognosis with respect to the opening of public procurement contracts is that it will proceed slowly, characterized by an interaction of political pressure with the demands for creating a more efficient public services infrastructure compatible with the objectives of EC-92. There is a consensus among both E.C.-owned and U.S.-owned companies in Europe that the proposal will not worsen U.S. companies' existing access to a public procurement market that is highly protected by member state governments and that the process could achieve some increased opportunities for U.S. firms with an investment presence in Europe. It also should be emphasized that, within the E.C., the proposed rule creates an option as far as considering U.S.-content bids are concerned. No purchaser is obliged to set aside a U.S.-origin bid, whatever the level of its E.C.-content.

On the negative side, the explicitly protectionist "buy European" provision will probably be accepted in some form. Some U.S. industries have indicated that the 3 percent margin rule will be a substantial handicap. More generally, the adoption of an explicit local content standard combined with the restriction of public procurement liberalization to E.C.-source products and services is an unfortunate step. It could establish a new and perhaps significant trade barrier between the E.C. and other countries, at the same time as the E.C. and its trading partners are seeking liberalization of trading rules in the GATT negotiating round, and national governments around the world are weighing the advantages of protectionist versus liberal trade policies.

In this environment it is important for U.S. companies to realize, as many already have, that major multinational alliances designed to gain access to public procurement markets in the E.C. could precede, not follow, the effective implementation of EC-92 directives. For example, the last two years in the telecommunications and electronics sectors have seen:

-- The acquisition battle among Siemens, AT&T-Philips and Ericsson for the second-ranking French public network telecommunications equipment supplier;

-- The announcement on February 13, 1989, of a partnership between AT&T and publicly-owned Italtel of Italy in the development and marketing of public and private telecommunications equipment for Italy, Europe, the United States and other markets;

-- The joint GEC-Siemens hostile takeover bid for Plessey, the British defense contractor and electronics firm, a battle in which the U.S. firm General Elective has also played a major role;

-- The IBM-Siemens joint venture in the marketing of private business exchange switching equipment.

The apparent lesson, for U.S. companies who wish to be competitive if the public procurement market opens up, is that it may be risky to await the shakeout of European suppliers or the full opening of the market to outside producers through negotiated trade agreements. Within the excluded sectors public procurement market, the first essential move may be the establishment or strengthening of local ties through the company's own E.C. base and through close relationships with E.C. producers.

3. RECIPROCITY

No issue has been of greater concern to the U.S. public regarding EC-92 than the question of reciprocity and whether the E.C. is seeking to construct a "Fortress Europe." This subject has already been broached in the previous section on public procurement; in the fourth section we will look in more depth at trade reciprocity aspects of policies in specific sectors which are of particular commercial policy interest in the E.C. This section will look at the more general evolution of the reciprocity issue.

In recent months, the outgoing E.C. Trade Commissioner, Willy de Clerq, has stated several times that any opening of the E.C. market to foreign firms would have to be matched by reciprocity in their markets for E.C.-based companies. These remarks contributed to a high level of international concern that the internal market meant the E.C. was retreating into a "Fortress Europe." Foreign access would only be granted on the basis of specifically negotiated bilateral reciprocal agreements. Concern over such an evolution of E.C. policy has been openly expressed here by the Secretary of Commerce and high-level representatives of the State and Treasury Departments.

This concern is amplified because the United States and the E.C. are also participating in the Uruguay Round negotiations on changing the rules in the GATT, the multilateral international trading system. The current commitment is to complete the GATT negotiations by 1990. But it is hardly likely that the E.C., which negotiates as a unit in trade issues with the rest of the world, will make any GATT commitments that would run afoul of its own evolving EC-92 policies on, for example, state subsidies, public procurement, local content and sectoral trade issues.

Another key issue is the question of the rights of foreign-owned enterprises operating in the E.C., in view of the reciprocity policy and Article 58 of the Treaty of Rome. Article 58 provides that any company organized to do business within the EC -- without any explicit statement as to ultimate parentage of the company -- shall be considered as having the same rights under the treaty as a "natural person." The reciprocity approach -- particularly as framed in the draft Second Banking Directive of June 1988 -- seemed to call into question retrospectively the rights of U.S. subsidiaries established in the E.C., if it were determined that their home government did not provide "comparable market access" to E.C.-based enterprises. Reports that the Commission's Legal Service was being asked to review the application of Article 58 to foreign investment within the E.C. added to these concerns, even though no final report on this issue has been produced.

In an important statement issued on October 19, 1988, the Commission sought to define more clearly its position on the general question of reciprocity and related specific issues. The Commission took the unusual step of publicly declaring the outcome of an internal "policy debate" within the Commission itself in this statement, entitled Europe 1992: Europe World Partner. The statement sought to reassure trading partners that "1992 Europe will not be a fortress Europe but a partnership Europe."

On the general issue of reciprocity, the Commission undertook a fundamental definition of this term. The statement emphasized the E.C.'s existing international trade commitments as well as a commitment to achieve further liberalizations of market access through GATT multilateral negotiations -- but maintained that "It would be premature to grant non-member countries automatic and unilateral access to the benefits of the [E.C.] liberalization process before such new agreements exist." This was a restatement of the basic position of no automatic extension of benefits, without reciprocal rights for E.C. producers in the trading partner's home country.

But the statement followed with an important series of qualifications regarding the meaning of reciprocal access:

-- The E.C. seeks "similar...or at least non-discriminatory opportunities in [foreign] firms' home countries..."

-- "Nor does reciprocity mean that the Community will ask its partners to adopt legislation similar to its own."

-- The E.C. will not seek "sectoral reciprocity based on comparative trade levels, this being a concept whose introduction into United States legislation has been fought by the Community."

The key, in other words, was the general existence of fair and "comparable" market access (a term used in the U.S. International Banking Act of 1978), not mirror market-opening legislation. There would appear, for example, to be leeway for accepting that U.S. state regulations against interstate banking should not be used to bar U.S.-owned banks from acquiring branches across national boundaries in the E.C., as long as the U.S. rules were applied in the same manner to domestic and foreign-controlled banks.

Such an interpretation would conform to the important principle of national treatment. This principle means the treatment of foreign enterprises on the same basis as domestic enterprises and in accordance with international law. It has increasingly gained support as a major principle of international law, in bilateral treaties, in policy positions of the multilateral Organization for Economic Cooperation and Development (OECD) and in U.S. international economic policy positions.

On the other hand, the E.C. would not extend non-discriminatory or "national" treatment to companies in cases where the non-E.C. host government does not provide equivalent non-discriminatory access. For example, blatant discrimination against foreign suppliers through such laws as the Buy American Act would mean that U.S. exporters could not fully participate in the opening of the E.C. public procurement market.

The October 19 statement added a number of important clarifications under the heading of "specific aspects" of application of the policy. Some of the more significant ones for U.S. industry can be summarized as follows:

External aspects of the removal of physical frontiers (quotas): This subject is not, strictly speaking, a reciprocity issue, though obviously a matter of great importance to the E.C.'s trading partners. The statement promised that "Completion of the single market will mean the removal of quantitative restrictions and will require unified [i.e., E.C.-wide] import rules in respect of non-Community countries. It is possible, however, that in a number of sensitive spheres, national measures will have to be replaced by Community measures." As will be shown in the next section, this particularly refers to automotive quotas. In such cases, the Commission promises, "These measures will not result in a higher level of protection than at present."

Technical standards and public procurement: The Commission reemphasized that the program in these areas would completely respect existing international obligations. As far as standards are concerned, this includes adoption of existing international standards as E.C. standards, where applicable. But both the mutual recognition of testing and certification procedures and access to public procurement in those sectors excluded from GATT agreements would have to be the subject of future negotiations.

Capital movement and financial services: The Commission reaffirmed the principal of erga omnes regarding capital flows, which means free movement whatever the source or ownership of capital within the E.C. (see Section 9 below). The Commission also established some important qualifications regarding the proposed Second Banking Directive and Article 58 concerns of U.S. companies. While indicating possible restrictions on "newcomers" based on reciprocity of access, the Commission stated that "...There can be no question of depriving the subsidiaries of foreign firms already established in Community Member States of the rights they have acquired."

Competition policy and takeovers: In view of the proposed E.C. regulation on competition policy discussed in Section 8 below, the Commission made an extremely significant statement that could have some implications for U.S. companies. It noted that, "Should any Community rules on takeover bids be drawn up, the possibility of including provision for obtaining comparable conditions for Community firms in the non-member country concerned should be considered in cases where a firm from a non-member country is the purchaser."

The general statement on reciprocity has helped reassure U.S. companies presently operating in Europe that they will not be the target of a general "Fortress Europe" policy, which uses U.S. companies in the E.C. as hostages to insure access for the E.C. on totally equal terms in the U.S. market. But the statement is not a blanket endorsement of the national treatment principle -- even though all member states of the E.C. have individually endorsed this principle by signing the 1976 OECD national treatment declaration. And the E.C. has not clearly indicated that it will apply Article 58 as an unqualified basis to future establishment of foreign-owned enterprises in the E.C.

The E.C. has not abandoned its general philosophy of reciprocity as an approach to solving the problem of how to ensure that producers in the E.C. are the primary beneficiaries of EC-92. How this policy may be applied in some important specific sectors is the focus of the next section of the report.

4. SECTORAL ISSUES

A major subject within the EC-92 program is the effect of internal market liberalization on E.C. trade and competitiveness in specific commercial sectors. Generally, the E.C. is moving toward a common commercial policy in such sectors, which means not only liberalization of the internal market, but a common external trade policy, including elimination of remaining national trade barriers against non-E.C. goods. The battle over reciprocity in particular may be mostly fought over such specific sectoral trade issues. All commercial sectors may be affected in varying degrees, but three sectors especially illustrate the broad scope of the policies and practices that will be changed due to the impact of the EC-92 program.

a) Automotive Trade

The "globalization" of existing E.C. national quotas is perhaps the most politically explosive subject on the EC-92 agenda, both among member states and in trade relations with the rest of the world. A U.S. auto company executive in Europe explains why in the following estimate:

> Without quotas and assumed politically motivated restraints in some countries, the overall Japanese share of the European new-car market could rise from the current 11 percent to as high as the 30 percent that we see in North America. That shift would threaten perhaps ten major assembly plants and as many as 300,000 jobs in Europe.

Some E.C. countries, such as Germany and the Benelux countries, maintain no quotas on Japanese car exports to their markets. The U.K. maintains only an informally negotiated industry-to-industry "gentlemen's agreement." This effectively holds down the level of imports to around 11 percent. Also, Japanese companies have been required to meet a local content standard if they are to receive regional aid, and if vehicles from factories in the U.K. are not to be counted against the voluntary restraint agreement. France uses its vehicle registration procedures to keep Japanese imports to 3 percent of the market, while Italy and Spain allow only a small, specified number of units, under quotas registered with the GATT. Thus, not only quota levels but the nature and implementation of the quotas vary significantly among the E.C. member states.

No decision has been taken regarding the harmonization of Japanese car quotas. The French government and automobile industry have pressed for an E.C.-wide quota, with an 80 percent local content standard to prevent Japanese evasion of the quota through assembly operations. Both the German government and car industry have opposed such a stringent quota and local content policy. At this point, only two principles appear relatively certain:

-- There will be some type of E.C.-level restraint;

-- In principle, any restraint will be temporary.

In 1988, the Brussels-based European carmakers association (CCMC - representing all major E.C.-owned companies) did adopt a common industry position. This position called for the stabilization of total Japanese exports to the E.C., at least until E.C. car exports to Japan reached half the level of Japanese exports to the E.C. CCMC called for establishment of an 80 percent E.C.-content standard to determine whether cars made by Japanese producers should count against the number of units included in the stabilization agreement. But under pressure from German companies this common position is currently being reassessed in view of the question of the impact on automotive trade with the United States.

The automotive quota issue is of major concern to U.S. interests for a number of reasons. The two largest U.S. car manufacturers have extensive operations in the E.C. and are among the six companies that hold roughly coequal leading shares of the mass market. At present neither company is actively supporting tough E.C.-wide quotas on Japanese cars. In fact, there is serious concern in Europe that Ford and GM could potentially cooperate with Japanese companies in exporting U.S.-assembled "transplants" into the E.C., to take advantage of low dollar-based costs and avoid any E.C. quotas on vehicles shipped directly from Japan. There are strong disagreements within the E.C. car industry on how this issue should be handled. For its part, the U.S. government has not so far indicated that it would accept any E.C. effort to transfer national E.C. car quotas to a global quota, especially if such a quota were made to apply to goods shipped from the United States.

b) Telecommunications

No issue in EC-92 is thornier than its application to the telecommunications sector. A more efficient, less nationally-oriented and more internationally competitive telecommunications services and equipment sector is viewed as perhaps the crucial link in creating a more integrated E.C. internal market. The Cecchini study reports estimates of telecommunications equipment costs across the E.C. as being 80-100 percent higher than in the United States, with costs of business customer services typically higher by a similar proportion.

The strategy of the Commission is set out in its basic document on telecommunications policy, the "Green Paper" of June 30, 1987. One year later, the Council of Ministers approved a resolution explicitly linking development of a common market for telecommunications services and equipment to the EC-92 program. The telecommunications policy for the Commission is developed within a self-contained telecommunications directorate, DG XIII.

The Green Paper in fact represents a compromise between the traditional European concept of publicly-owned basic telecommunications network services and the newer international trend of establishing a free (or at least freer) market in services using the basic network and the equipment that can be linked to it. Basic services, redefined in the Green Paper as the "reserved services," are those which will be provided by Government-owned or government-licensed telecommunications monopolies, based primarily on the principle of universal access and availability. Traditionally, this has clearly included telephone and telex service.

"Competitive services" are defined as including not only the manipulation and processing of data carried on the basic network, (the so-called "value-added" services) but also providing "intelligent networks" that handle communications according to a customer's own needs, often on equipment that the customer may have purchased and installed from an independent vendor. Another key compromise in the Green Paper is that the national telecommunications administrations (PTTs) would be allowed to participate in the competitive services market, while retaining their regulatory and reserved services functions.

To implement this policy, which leaves the "integrity" of the national basic services network intact, while encouraging the competitive stimulus of alternative equipment and services providers, the E.C. has adopted or proposed a number of specific steps. The development of these specific policy initiatives will be crucial for U.S.-owned companies that hope to be competitive in the evolving E.C. telecommunications market for both services and equipment:

-- Opening of telecommunications procurement. This issue was discussed in the previous section on public procurement. In addition to the comments above, it should be noted that the draft directive of October 1988 requires a compulsory public and international call for all works and supply contracts. This includes a compulsory annual information notice announcing all intended purchases for the year ahead. Also, as with existing procurement directives, there is a requirement for full transparency of the purchasing behavior of the telecommunications entities in E.C. member states.

The E.C. policy does not initially address continued discrimination against non-E.C. source products and services. It does allows member countries at their discretion to entertain competitive non-E.C.-source bids. And, as mentioned earlier, it indicates that the E.C. intends to negotiate bilateral and multilateral market access agreements.

The policy apparently conflicts with the telecommunications reciprocity provisions of the U.S. Omnibus Trade Act. Section 1374 of the U.S. law provides for the citation by USTR of those foreign countries denying equivalent market access to U.S. firms. In an announcement of February 21, 1989, the USTR stated that this provision at present includes some E.C. countries. The draft E.C. procurement directive would in principle ameliorate the current situation by guaranteeing equal access for those U.S. firms operating in the E.C., which provide products and services meeting the E.C. local content standard. However, the U.S. Trade Act provisions are also concerned with improved markets for U.S. exports, which would not be enhanced by the provisions of the draft telecommunications procurement directive, unless E.C. member states decided to accept U.S.-source bids.

Accordingly, the Office of the USTR identified the E.C. (along with Korea) as a "priority country" for negotiations involving telecommunications market access, as provided by the Trade Act. This decision is directed at existing market barriers to U.S. products and services. The USTR announcement does indicate that the degree of access varies considerably within the E.C.

-- Provision of terminal equipment and telecommunications services. In addition to the effort to open the public procurement market, the E.C. has already adopted a directive requiring member countries to eliminate all exclusive and special rights to telecommunications entities for the importation, marketing, connection and maintenance of telecommunications terminal equipment. The terminal equipment directive entered into force on May 16, 1988. But France has challenged the validity of this directive before the Court of Justice, on grounds that the E.C. has overreached its treaty authority. Meanwhile, there is a similar draft directive under discussion that would require member countries to eliminate exclusive or special rights granted to telecommunications entities for the provision of "non-basic" telecommunications services.

-- European Telecommunications Standards Institute (ETSI). In conjunction with CEN/CENELEC, this body will establish agreed European standards for telecommunications equipment and services. The significance of ETSI is that it removes this function from the exclusive control of the European Conference of Postal and Telecommunications Administrations (CEPT), a collaborative body consisting solely of PTTs. CEPT will participate in ETSI standard-setting, but ETSI will also include other equipment and services providers, and user groups. ETSI, located in the south of France, began functioning in April 1988. All E.C. member state telecommunications authorities are now required to use agreed European standards as the basis for type approval of telecommunications terminal equipment.

-- E.C.-sponsored research on common standards in advanced technologies (RACE and ISDN). The Council of Ministers in 1986 approved a non-binding Recommendation on the coordinated introduction of an Integrated Services Digital Network. This will allow Europe-wide voice, video and data capabilities via the national telecommunications network. In December 1987, the E.C. also approved the "main phase" of the RACE project, RACE being an acronym for a program of pre-competitive R&D aimed at creating common standards in Europe for integrated "broadband" voice, video text and graphics communication. The main phase of RACE (to be completed by 1992) is open to the European subsidiaries of U.S. companies.

-- Open network provisions (ONP). The Commission is currently preparing a directive on the conditions of access to networks. An initial proposal was approved in December 1988.

c) Information Technology and Advanced Electronics

The E.C.'s collective sense of inferiority regarding telecommunications equipment and services extends to information technologies more generally. While there are many excellent and world-class E.C.-based companies in this broad field, most observers believe that the E.C. lags behind both the United States and Japan in many key areas, and that the balkanization of the E.C. market has been a major cause of this lag.

On the other hand, the E.C. seems more committed as a matter of policy to ensure that it retains a competitive base in the information technologies and electronics products industries -- across the board from chips to consumer products. There is a strong sense among many E.C. companies and other groups that the U.S. policy of opening its consumer electronics and telecommunications equipment markets to foreign producers, without adequate safeguards against import surges, dumped goods and predatory pricing, and without requiring reciprocal access, was a major mistake.

It would be wrong, however, to indicate that there is a complete consensus within the E.C. as to the policy measures needed to improve E.C. world competitiveness in the advanced electronics industries. In this report, we will focus on one particularly significant E.C.-sponsored research program -- ESPRIT -- both as a guide to the E.C.'s overall policy direction and to the relationship with U.S. interests.

ESPRIT is the acronym for the European Program for Research and Development in Information Technology. ESPRIT was established in 1984 to promote precompetitive intra-European technological research cooperation on information technology projects with commercial applications. The program provides matching funds (on a 50-50 basis) for approved precompetitive research projects selected from corporate, academic and government research laboratory proposals.

The first phase of ESPRIT, with a total budget of 1.5 billion ECUs (nearly $2 billion), was completed by 1988. To quote from a recent article on ESPRIT by Jonathan Todd in the May 1988 issue of the E.C. Delegation magazine Europe, the program "concentrated on microelectronics, advanced information processing systems (including software) and application technologies, including computer-integrated manufacturing and office systems." The Council of Ministers was sufficiently impressed with the results of the program to double its budget for the period 1989-93.

U.S. companies in Europe have been concerned that the goals of ESPRIT may be more oriented to improving the competitiveness of E.C. firms, rather than E.C.-based industry. This is perceived by some companies as reducing the opportunities for participation by U.S. firms operating in Europe. For example, the Todd article, which summarizes numerous projects, fails to mention any non-E.C. firms, even though U.S. companies operating in Europe played important roles in some ESPRIT projects. Similarly, some U.S. companies operating in Europe, that have developed proposals relevant to ESPRIT and other E.C.-sponsored research programs, have been informally advised to allow E.C. companies to take the lead in proposing such projects to insure approval.

Heightening this concern over possible current "second-class status" for U.S. companies' participation in some E.C.-sponsored research programs is the fear, mentioned by at least one U.S. company, of an E.C. backlash against similar tendencies in U.S. government-supported programs in semiconductor and superconductivity research. Sources in the Commission note that Sematech and MCC remain closed to E.C.-owned, U.S.-based companies. If this "model" is pursued, they argue, in combination with Defense Department research that remains mostly closed to E.C. companies, then questions of mutual levels of access will increase on the E.C. side.

The primary consequence of exclusion of U.S.-owned firms from such officially-sponsored E.C. research could be in the standards area. One example may be seen in the Todd article, which cites, "'Herode,' a highly successful ESPRIT project led by Siemens, [which] developed a new international standard for office documentation architecture (ODA), now officially adopted by the International Standards Organization (ISO 8613). Siemens has been joined by ICL, Olivetti and Bull on a new project to develop practical applications for ODA, which must compete on the market against IBM's DCA/DIA standard." But, in fairness to the E.C., it should be noted that there are many ambiguities regarding competition and cooperation in these evolving information technology fields. For example, the Commission cites the fact that IBM Germany does have a minority participation role in the ESPRIT II ODA continuation project.

The general development of E.C. standards in information technology is proceeding through the application of the principles of Open Standards Interconnection (OSI). All U.S. companies with an interest in the E.C. market should become familiar with the E.C.'s OSI process. With the support of the E.C., an informal European Workshop on Open Standards (EWOS) has been established for the purpose of coordinating input from standards bodies, user groups and manufacturing organizations to develop E.C. standards in the evolving information technology field. EWOS is also to discuss standards issues with equivalent U.S. and Japanese groups. At the same time, OSI-based procedures for product testing and certification are also being established.

5. RULES OF ORIGIN AND LOCAL CONTENT

The previous sections raise a number of general questions about local content policies in the E.C. and rules of origin. These will be important issues in the context of the overall development of the EC-92 program. At present, the E.C. does not maintain a general local content policy. And rules of origin for non-preferential trading partners, such as the United States and Japan, are based on a rule adopted in 1968. This states that origin is conferred in the country where the last substantial process or operation that was economically justified was performed, providing also that a new product was thus created, or at least a major new stage in the manufacturing process resulted. This rule is similar in nature to the "substantial transformation" test used by the United States.

Since then, the E.C. has considered and adopted criteria to determine the last substantial operation for a number of specific products, such as radios, televisions, tape recorders, textile products, ceramic products and roller bearings. Currently, decisions are being made regarding rules of origin for semiconductors and copiers. As the subjects of these "rules of origin" decisions become more numerous, the concern is increasing that a de facto local content policy will emerge.

Local Content Rule for Antidumping Enforcement

The E.C. does maintain percentage content rules in some specific cases. Perhaps the most important example of such rules is the 40-percent local content rule applied to companies found to be dumping or illegally subsidizing exports to the E.C. market. An E.C. regulation of July 1988 (EEC 2423/88) on application of antidumping or countervailing duties addresses the problem of "screwdriver" plants -- that is, final assembly operations that may be established to circumvent E.C. anti-dumping penalties. This regulation provided that anti-dumping duties could be applied to products whose final assembly was in the E.C. The penalty can be applied to goods shipped under the following conditions:

- Assembly is carried out "by a party which is related or associated to any of the manufacturers whose exports of the like product are subject to a definitive anti-dumping duty..."
- The "value of parts and materials" produced in the country of exportation subject to the anti-dumping rule is more than 60 percent.
- The assembly operation is started or substantially increased after the anti-dumping investigation was opened.

This 40 percent rule can be ameliorated by the possibility of including costs of "research and development carried out in and the technology applied within the Community." According to Commission staff sources, the E.C. has in practice reached accommodations with related assembly companies in "virtually all anti-circumvention cases." At the current time, there are no duties being levied at the premises of assemblers in the E.C.

What is especially important from the U.S. perspective is that the the terms of this regulation could apply to production arrangements in third countries. However, the

40-percent content rule is not necessarily an E.C. content rule. Paragraph 5 of the regulation states that, "Where a product is imported into the Community from more than one country, duty shall be levied...on all imports of such product found to be dumped or subsidized...other than imports from those sources in respect of which undertakings have been accepted." (Emphasis added.)

Rules of Origin Applied to Goods from EFTA and ACP Countries

Members of the European Free Trade Association (Norway, Sweden, Iceland, Austria, Switzerland and, by associate status, Finland) have a reciprocal free-trade agreement with the E.C. The rule of origin applied to EFTA goods with respect to eligibility for free access to the E.C. market is 40 percent EFTA country content. This same level of local content is applied to goods shipped to the E.C. from over 60 African, Caribbean and Pacific area developing countries (ACP), which have a one-way (non-reciprocal) trade agreement with the E.C. under the terms of the Lome Convention. These are preferential access agreements, and the content standards applied to goods shipped to the E.C. from EFTA and ACP trade partners have, at present, no implication for more general trade and investment relations with other non-preferential trading partners.

E.C. Content and Rules of Origin under EC-92

No general guidelines for local content rules have yet been developed in EC-92 proposals, beyond those already discussed in detail with regard to public procurement in the excluded sectors. This comment includes the areas for which reciprocal access agreements may be considered. Other areas where such rules may be considered and developed notably include the question of harmonized rules governing state aids and subsidies to investors, particularly in economically depressed regions and industries. This may require a decision regarding minimum levels of local content for an industry to be eligible for such assistance, an issue which has already arisen, for example, in the case of U.K. regional aid for the Nissan "Bluebird" factory in Sunderland.

EC-92 is not proceeding in a vacuum, but at the same time as the GATT Uruguay Round. Local content rules are prominent among the issues being discussed at the GATT, principally in conjunction with efforts to address trade-related investment measures. The E.C. has in generally supported the U.S. view that such measures should fall under GATT restrictions or prohibitions. It is a concern of both U.S. industry and the U.S. government that the evolution of E.C. policy, particularly in establishing E.C.-wide rules to harmonize existing national practices, should not conflict with the progress made in expanding GATT discipline over local content rules and policies.

6. INTELLECTUAL PROPERTY

The adequate protection of intellectual property rights is a major concern of both NAM member companies and U.S. international economic policy. A quick glance at the official U.S. balance of payments statistics reveals why. In 1987 -- the last year for which complete data are available -- U.S. companies reported earning over $9 billion from foreign sources in licensing fees and royalties, while paying foreigners only $1.3 billion: This 7:1 ratio remains the most asymmetrically positive component of the U.S. current account balance. It explains the major national interest, for example, in achieving a provision on intellectual property rights as a major goal in the current GATT negotiating round.

E.C. companies and member states also have a strong interest in protecting intellectual property rights, both internationally and within the E.C. context. The effort to achieve an improved and harmonized system of intellectual property rights within Europe antedates the 1992 internal market program, though the effort remains incomplete and unfinished. For example, an E.C. Patent Convention was signed in 1975. However, as of late 1988, five of the smaller or newer member states (Denmark, Ireland, Spain, Portugal and Greece) still had not signed the convention. A European Patent Office, with membership extending to many non-E.C. European countries, has been established in Munich. Completing and improving a harmonized E.C. intellectual property rights system is seen as an important task if a more integrated internal market is to be achieved. It is also considered essential to the development of world-class competitive technologies across European national borders.

A summary of some of the major intellectual property initiatives and their present status follows. It is largely based on information provided in the latest Business Guide to EC Initiatives, published by the American Chamber of Commerce in Belgium (see appended guide to information sources).

Regulation on Counterfeit Goods (adopted 1986 by Council of Ministers, entered into force January 1, 1988). This regulation established an E.C.-wide policy to allow the confiscation of counterfeit goods imported from third countries, thus preventing their circulation and sale anywhere within the E.C. The regulation, it should be noted, applies only to goods which infringe registered trademarks. The regulation could be enlarged to include other intellectual property rights such as copyrights in 1991.

Regulation on Community Trademark and Community Trademark Office (consolidated text including member state reservations before Council for final action). This could establish a central E.C. Trademark Office in Madrid, with a Board of Appeal in Luxembourg, the seat of the ECJ. It would eliminate the present need to register trademarks in each of the ten separate national jurisdictions (Benelux presently maintains a single system for those three countries) -- though these national systems would not be eliminated.

Benefits for U.S. companies could include the elimination of national compulsory use rules, since once the trademark has been used in one member state, it would be valid throughout the E.C. Also, recognition of an infringement in one member state could also be extended to prevent use in all other E.C. markets. But the current E.C. proposals contain provisions that could create some potential disadvantages for U.S. companies. These include a proposed cumbersome search procedure and the possibility that the refusal of one national registry to accept a proposed trademark application means a failure in all E.C. jurisdictions.

Directive on Trademarks (adopted in final form in December 1988). This important directive will establish harmonized national trademark rules. It includes a five year compulsory working proposal -- the trademark must be put to use within five years in the member state where registered, or be revoked on an E.C.-wide basis. Use in one member state validates the trademark for the whole of the E.C., which would be to the advantage of U.S. companies. All member governments are required to adopt conforming legislation within three years of final adoption by the Council of Ministers.

Community Patent Convention (signed 1975, but still not ratified by five E.C. member states, as indicated above). Once all E.C. members have signed, the CPC will protect patent rights in each E.C. country and the patent will have the same force in all E.C. member states.

Commission Green Paper on Copyright and the Challenge of Technology (issued June 7, 1988). This document outlines the copyright issues requiring immediate E.C. action, regarding application of copyright recognition to newer electronically-oriented technologies. The paper also provides a basis for the future E.C. role in the international development of intellectual property rights. As a result of the green paper, the EC Commission has proposed a directive that would extend copyright protection to computer programs. Such programs would generally be protected as other literary works under the Berne Copyright Convention. Other initiatives concerning electronic data bases and digital audio tape are likely to result from the green paper. The broadening of protection complements similar steps in the United States that have been supported by industry.

Directive on Semiconductor Topographies The E.C. has adopted a directive on the copyright protection of semiconductor designs, but only five countries (Germany, Denmark, France, U.K. and the Netherlands) have so far implemented this directive.

One further issue that should be noted here is the reciprocal treatment of E.C. intellectual property rights under Section 337 of U.S. trade law. Recent reports indicate that a GATT panel has upheld the E.C. claim. The E.C. argued that Section 337 discriminates unfairly against foreign companies that export to the United States by setting up a separate process under the International Trade Commission, rather than the federal courts, for claims relating to ownership of intellectual property rights. It was argued by the E.C., apparently successfully, that Section 337 procedures do not provide the importers with defenses comparable to those available in purely domestic cases. Since a final GATT decision has not been announced, it is not yet clear what impact this decision will have on U.S.-E.C. relations in the intellectual property rights area.

7. SOCIAL DIMENSION

The previous sections in Part II have all dealt with issues involving international trade questions and the reciprocal treatment of companies and products by the E.C. and the United States. The last three issues are different, in that they do not directly involve U.S.-E.C. economic relations, but general policy choices by the E.C. that may have a major effect on how U.S. companies do business in the European Community.

The question of the social dimension of the Internal Market has become one of the most critical subjects associated with EC-92. This is especially due to the goal of increased employment opportunity throughout the E.C., as discussed in the first part of this paper. And there have been important debates within the E.C. over the most appropriate and effective E.C. role in addressing the social dimension. This debate was stimulated by a speech that Commission President Delors made in 1988 to the annual meeting of the British Trade Unions Congress. He declared, "It is impossible to build Europe only on deregulation...The social dimension is a vital element."

What is meant by the "social dimension?" It has been defined by Delors himself in this way:

> -- First, measures adopted to complete the large market should not diminish the level of social protection already achieved in the member states.
>
> -- Second, the internal market should be designed to benefit each and every citizen of the Community. It is therefore necessary to improve workers' living and working conditions and to provide better protection for their health and safety at work.
>
> -- Third, the measures to be taken will concern the area of collective bargaining and legislation.

Some approaches to developing these points may be seen in a lengthy "Working Paper" on the Social Dimension, released in September by the Commission. It reflects a series of views within the Commission, primarily DG V (Employment, Social Affairs and Education). The paper basically combines two strands of action, both contained in Delors' more formally stated views.

First, there is a major concern expressed in the paper with improving labor mobility, training (especially in the poorer regions) and occupational health and safety protection. This agenda merges rather well with the Cockfield White Paper of 1985. The White Paper emphasized the physical mobility of persons and specifically proposed directives to harmonize health and safety standards for workers throughout the E.C.

European business, including U.S. companies operating in Europe, have been active supporters of the EC-92 program, and have tried to assist President Delors in increasing the momentum in public support for the program. This has included very positive support for the goals of EC-92 regarding increased worker mobility, improved working training and a generally more competitive labor market infrastructure throughout the E.C. For its part, the Commission has been extremely interested in examining innovative approaches from outside the E.C. itself, including the United States, Japan and the EFTA countries.

Secondly, the Working Paper also included proposals to establish E.C.-wide collective bargaining and mandatory employee consultation and information rules, long-standing goals of some European labor federations. It further suggested that EC-92 and consolidation of the internal market had led to concerns about "social dumping," the migration of industry to areas in the E.C. with low wage levels and, in the view of European labor federations, low standards of worker rights protection.

Four specific proposals or issues now before the Council of Ministers, all having a long history that predates the EC-92 proposal, are related to this second agenda:

1) Worker Consultation and Information. This was the subject of the controversial "Vredeling Directive" of 1980, which still formally lies before the Council. It is unlikely that the Vredeling proposal, with its requirement of extensive sharing by management of commercially-sensitive information with employee representatives in advance of corporate decisions, will be acted on in the near future. While the September 1988 working paper indicates that some type of general consultation and information proposal should be considered as part of the Social Dimension package, several draft documents relating to this issue have been withdrawn or sent back for redrafting, indicating lack of a consensus on this subject.

2) Workplace Health and Safety Directive. Since final Council action will probably be delayed indefinitely on a worker consultation and information directive because of its controversial nature, we can anticipate that there will be efforts to achieve some of these objectives partially through policy in other functional areas. One possible example is the proposed framework directive of March 1988 on health and safety in the workplace, which aims at achieving a uniformly high standard of worker protection at the workplace throughout the E.C.

The general goal of this directive is supported by E.C. industry, in keeping with general business support for E.C. safety standards on specific problems such as noise in the workplace or exposure to asbestos. For the most part, the draft directive focuses on employer and worker responsibilities regarding safety and health standards, actions and training in the workplace environment. However, Article 5 ("Employer Obligations") would require that all "planning and introduction of new technologies shall be undertaken in close cooperation with the workers and/or their representatives, particularly in respect of the choice of equipment and the working conditions, including those aspects connected with the working environment and the physical and psycho-social well-being of the individual." Such language could obviously be subject to expansive interpretation.

3) The European Company Statute. President Delors has revived the proposal to allow companies to choose to incorporate as "European" companies, rather than as companies organized in a specific member state. Potentially, this could allow a company to gain certain tax advantages, from being able to consolidate financial reporting at the European level. But Delors' initial proposal would require that a company choose some type of

formal system of worker participation in management decisions. Following the initial negative reaction by industry, the Council of Ministers directed the Commission to draft a new European Company Statute proposal in early 1989.

4) Fifth Company Law Directive. The company law directives are generally aimed at harmonizing corporate practices and structures throughout the E.C. The Fifth Directive concerns the organization of public limited companies and their management structure. The major controversy since the initial proposal of the directive in 1972 has been the proposed requirement for some type of employee participation in the company's overall board structure. Having been approved with amendments by the European Parliament, this directive is now again the subject of consultations between the Commission and the Council of Ministers.

Employers' Views

At present, NAM and other U.S. employers' organizations in the United States and Europe are developing a common position in response to the Social Dimension program. In general, these organizations have reacted favorably with respect to the first part of the Commission agenda, which focuses on improving the overall E.C. standard of worker education, training and mobility, and thus contributing to a reduction of the high rate of unemployment in Europe. In recent years, representatives of member companies have met in a series of seminars with Commission staff to explore U.S. and E.C. private and public sector cooperative approaches to these issues.

On the other hand, the reaction of business organizations in Europe has been negative to those proposals which seek to expand consultation and information requirements on an E.C.-wide basis. While no new formal position can be taken until further draft proposals are submitted, the view on existing proposals is that they are not necessary for the development of a more integrated internal market. Indeed, "harmonizing up" in terms of creating more rigid labor policies may reduce investment in those areas that need it the most. And there is widespread evidence, cited in the Commission's own studies, that more rigid labor relations rules that restrict the flexibility of management decisions will add to the unemployment problem in the E.C., not reduce it.

There is little possibility at present that these kinds of proposals could achieve the unanimous approval in the Council of Ministers which will be required under Article 100a for adopting policies affecting social affairs and employee rights. In particular, the U.K. government, with the strong support of British industry, is committed to oppose any new E.C. industrial relations policy which it believes will destroy the balance that it feels has been restored in British labor-management relations over the last decade. The concern remains in some quarters, however, that an effort will be made to achieve such policies through directives and other proposals ostensibly related to the other areas covered by the Internal Market program. This could lead to a confrontation within the E.C. over the interpretation of the SEA itself.

8. COMPETITION POLICY

The E.C. actively and directly regulates competition in Europe, under authority assigned to it by Articles 85-86 of the Treaty of Rome. This means that the E.C. may establish regulations which have the force of law within the member states. DG IV is the competition policy directorate. Since the 1985 Cockfield White Paper was developed in DG III, it did not include any specific competition policy proposals. However, there is no doubt that major changes in competition policy within Europe must accompany the development of EC-92.

This is because member state governments also retain rights of regulating competition. The coexistence of E.C. and member state regulation creates a patchwork of rules regulating mergers and takeovers within the E.C. and results in companies in different E.C. countries playing by quite different rules. The assumption is that member state governments, through their own competition and merger control policies, should not be able to frustrate cross-border mergers and acquisitions needed to create larger economies of scale and enhance E.C. international competitiveness. And because U.S. companies have typically expanded in Europe by acquiring existing E.C. firms or establishing joint venture arrangements with them, any major changes proposed in competition policy will have a major effect on the ability of U.S.-owned firms to cope with EC-92 market changes.

E.C. enforcement of competition policy has been restricted to company practices, and has not included direct control of mergers and acquisitions. Each country has its own policy in this latter area. The U.K. and Germany have the most aggressive national antitrust policies of the U.S. type, enforced through the Mergers and Monopolies Commission and the Bundeskartellamt, respectively. Other countries, such as France and Italy, do not have highly developed antitrust policies, but do control company actions and merger activities as a function of national industrial policies, tax laws, price controls and other policies. Among all the E.C. countries, only the U.K. allows hostile takeovers similar to the U.S. model. And some specifically discriminate against foreign acquisitions -- the Netherlands, for example, allows only 20 percent of the voting shares of any publicly-owned Dutch company to be held by foreign persons.

Proposals to establish direct E.C. control over mergers and acquisitions have been debated in Community institutions for fifteen years, with little forward progress. But the imminence of the enhanced internal market has spurred progress toward achievement of a new E.C. regulation in this area. The major proposal to emerge from DG IV, under the leadership of departing Commissioner Peter Sutherland, is the revised draft regulation to establish E.C. control over all mergers "having a Community dimension." It was proposed by the Commission in May 1988, after considering EP amendments to earlier drafts. Several revised versions have subsequently been circulated.

This draft regulation would establish E.C. control over all proposed "concentrations" (mergers and acquisitions) of companies with an E.C. dimension. An E.C. dimension is defined as --

- -- Worldwide turnover greater than 1 billion ECUs for the companies combined;
- -- Aggregate E.C.-wide turnover of 100 million ECUs, with no more than 75 percent of the total in any one E.C. member state.

In a recent twelve-month period, the Commission counted 171 transactions that would have exceeded the turnover thresholds of the regulation, though only a relatively small share of these also met the distribution requirement. For such major cases, the Commission's intent is that it should become the sole regulating body. The preamble to the draft regulation states that, "In order to provide for a uniform system of control of concentrations having a Community dimension throughout the common market, the Member States must refrain from taking any measure which might undermine the full effect of decisions pursuant to this Regulation." (Paragraph 27, quoted from draft of July 25, 1988.)

Because the Treaty of Rome limits E.C. authority to the competition policy area, however, the very next paragraph establishes a major qualification: "...This principle does not prevent Member States from taking measures with a view to protecting legitimate interests other than competition..."

This qualification may critically affect the attitude of both E.C. companies and U.S.-owned companies active in Europe. There is strong acceptance of the concept of a Brussels-based competition policy authority, which could expedite the approval of mergers and acquisitions creating larger economies of scale in the E.C. On the other hand, both U.S. and many E.C. companies are concerned about the "double jeopardy" aspect of establishing a Brussels-based merger authority, while continuing to maintain a veto authority in the national capitals over acquisitions.

There is also a further issue that affects U.S. interests and that also currently obstructs U.K. acceptance of the principle of an E.C. merger regulation. This is whether there should be a single E.C. policy on hostile takeovers. Britain, virtually alone in the E.C., currently allows hostile takeovers (witness the recent battle between estle and Suchard, two Swiss confectionery companies, for the British company Rowntree Mackintosh, a firm with widespread activities and brand recognition throughout the E.C.). The U.K. government can stop takeovers, but principally on competition policy grounds. In the British view, it would be unfair to disarm the U.K. government's major defense against large takeovers that it views unfavorably, while permitting the effective ban on hostile takeovers in other E.C. countries.

This British view could force the E.C. and its members into a harmonization of takeover rules. Certainly it is interesting that the new British Conservative Commissioner, Sir Leon Brittan, who has been politically very close to Prime Minister Thatcher, has been selected to replace Sutherland as the competition policy commissioner. U.S. business readers should also recall the point noted earlier in discussing the Commission statement on reciprocity of October 19, 1988 -- that in applying any common takeover policy to non-E.C. firms, the Commission will consider the reciprocal rights of E.C. firms in the acquiring company's home market.

9. MONETARY POLICY

The commitment of the E.C. to closer monetary policy coordination will have a major impact on the way U.S. companies do business in Europe. At the same time, there are major issues in this area that will influence international monetary policy and exchange rate developments, and therefore the conditions of U.S. international trade.

In 1988, there were two critical developments:

1) Full Liberalization of Capital Movements within the E.C. On June 24, 1988, E.C. finance and economics ministers, meeting in the Council of Ministers, gave final approval to a directive providing for complete liberalization of capital movements within the E.C. This means the elimination of all foreign exchange controls. In addition, all domestic monetary regulations that have a specific impact on capital transactions with nonresidents are subject to a notification procedure.

All E.C. member states must eliminate any remaining capital movements restrictions by July 1, 1990, except for Spain, Ireland, Greece and Portugal, who have a grace period through 1992. The Belgium-Luxembourg economic union must also eliminate its dual exchange rate by the end of 1992. The balance of payments safeguard provisions of the Treaty of Rome remain in effect, but the Commission will have supervisory authority over the implementation and maintenance of emergency exchange controls by members. U.S. companies operating in the E.C. can therefore look to essentially complete implementation of free capital movements within the E.C. between now and 1992.

2) Monetary Union. Agreement on the capital liberalization directive both cleared the way for and impelled the E.C. toward consideration of an economic and monetary union. The success of the European Monetary System (EMS) also encouraged a strategy of closer monetary policy cooperation. The Hanover E.C. summit of heads of government on June 27-28, 1988, therefore decided to establish a committee with the task of studying and proposing concrete stages leading toward such a union. The nature and topic of study was the result of a compromise. Most E.C. governments would have been willing to include explicitly on the agenda the exploration of the questions of an E.C. central bank and a single E.C. currency, but such far-reaching measures were opposed by the British government, which has yet to join the EMS.

The importance of this subject to President Delors, formerly French finance minister, is indicated by the fact that he is personally chairing the study committee, and also holds the new Commission's monetary affairs portfolio. The leaders of E.C. central banks were also requested to join the committee in their "personal" capacities. The committee is to report its findings "in good time" before the scheduled heads of government summit in Madrid, in June 1989. Current plans call for release of a report in the spring, midway between the installation of the new Commission and the Madrid summit.

The report of the Delors committee will almost certainly make policy recommendations that go beyond the type of consultation and coordination of policies now existing within the EMS or the broader G-7 group of industrial countries. It is assumed that there would be some mandatory policy coordination features. Leaving aside the question of the British relationship to closer coordination, another essential issue is whether there should be a "once for all" major reevaluation of the Deutsche mark before implementation of some type of mandatory coordination system. Rates in the present EMS range keep other E.C. currencies, notably the French franc, closely aligned with the DM, and therefore effectively overvalued with respect to industrial competitiveness in third country markets. But the effect of a close EMS relationship with a strong DM has also had the salutary effect of sharply reducing inflation rates throughout the E.C.

The outcome of these discussions and decisions will have a major impact on U.S. international industrial competitiveness. The movement of the DM within the EMS will affect both dollar-rate production costs within the E.C. and the competitive prices of German and other E.C. manufactured goods on world markets. Of equal significance to U.S. companies, in combination with the complete liberalization of capital movements planned by 1990-92, will be the impact on production location decisions within the E.C. itself.

10. OTHER POTENTIAL ISSUES

Export Controls

An issue not covered by the general European Commission reciprocity statement of October 1988, but related to U.S. and E.C. trade policies is the export control question. The general U.S. business assumption is that EC-92 will eventually have to include a common export control policy. Presently, enforcement of the controls agreed by the international Committee for the Control of the Export of Strategic Commodities (COCOM) is heavily reliant on national customs inspections. But these will be eliminated within the E.C. by 1992. Individual E.C. countries now maintain national control systems of varying effectiveness, which has led to U.S. concerns over diversions of national security-sensitive products and technologies.

It is not yet clear exactly how the U.S. government and the E.C. will resolve differences in export licensing practices under EC-92 and how such arrangements may affect U.S. companies. But this is an issue that should be monitored closely by American high-technology companies.

Defense Procurement

Procurement for non-military purposes in the E.C. is already covered by the existing procurement directives, which are to be enhanced as part of the EC-92 program. However, procurement of material for specifically military purposes is excluded from both the GATT code and existing E.C. directives. The October 1988 communication on the excluded sectors indicates that there are no further policy proposals at this time relating to military procurement, but states that the Commission should consider some initiatives in the near future, so that "their adoption and implementation are in concordance with the realisation of the Internal Market by December 31, 1992."

The Commission statement does not indicate that improved world competitiveness by E.C. producers should be a consideration in this policy. Rather, it relates the policy to security cooperation that would enhance development of a "European identity in external policy matters." This also conforms to the political cooperation provisions included in the Single European Act. It is not yet clear what effect proposals on intra-E.C. defense procurement will have on the U.S. defense industry or existing procurement arrangements within NATO.

APPENDIX I

MEMBERS OF THE COMMISSION AND THEIR RESPONSIBILITIES

(As of January 1, 1989)

Jacques Delors (France)	Secretariat-General (including internal services) Legal Service Monetary Affairs Forward Studies Unit
Frans Andriessen (Netherlands)	External Relations and Trade Policy Cooperation with Other European Countries
Henning Christophersen (Denmark)	Economic and Financial Affairs Coordination of Structural Funds Statistical Office
Manuel Marin (Spain)	Cooperation and Development Fisheries
Filippo Maria Pandolfi (Italy)	Science, Research & Development Telecommunications, Information Technology and Innovation Joint Research Center
Martin Bangemann (F. R. Germany)	Internal Market and Industrial Affairs Relations with the European Parliament
Leon Brittan (United Kingdom)	Competition Financial Institutions
Carlo Ripa di Meana (Italy)	Environment Nuclear Safety Civil Protection
Antonio Cardoso e Cunha (Portugal)	Personnel and Administration Energy and Euratom Supply Agency Small Businesses, Distributive Trade and Tourism
Abel Matutes (Spain)	Mediterranean Policy Relations with Latin America North-South Relations

Appendix I (Cont.)

Peter Schmidhuber (F.R. Germany)	Budget Financial Control
Christiane Scrivener (France)	Taxation and Customs Union
Bruce Millan (United Kingdom)	Regional Policies
Jean Dondelinger (Luxembourg)	Audiovisual and Cultural Affairs Information and Communication A "People's Europe"
Ray MacSharry (Ireland)	Agriculture Rural Development
Karel Van Miert (Belgium)	Transport Credit and Investment Protection and Promotion of Consumer Interests
Vasso Papandreou (Greece)	Employment and Industrial Relations Social Affairs Human Resources Education and Training

Information provided by EC Office of Press and Public Affairs (Washington, D.C.).

DIRECTORATES-GENERAL

DG I	External Relations
DG II	Economic and Financial Affairs
DG III	Internal Market and Industrial Affairs Task Force: Small and Medium-sized Enterprises
DG IV	Agriculture
DG V	Employment, Social Affairs and Education
DG VI	Agriculture

Appendix I (Cont.)

DG VII	Transport
DG VIII	Development
DG IX	Personnel and Administration
DG X	Information, Communication and Culture
DG XI	Environment, Consumer Protection and Nuclear Safety
DG XII	Science, Research and Development Joint Research Centre
DG XIII	Telecommunications, Information Industries and Innovation
DG XIV	Fisheries
DG XV	Financial Institutions and Company Law
DG XVI	Regional Policy
DG XVII	Energy
DG XVIII	Credit and Investments
DG XIX	Budgets
DG XX	Financial Control
DG XXI	Customs Union and Indirect Taxation
DG XXII	Coordination of Structural Instruments

APPENDIX II

QUALIFIED MAJORITY VOTING IN THE COUNCIL OF MINISTERS

As provided in Article 100a of the revised Treaty of Rome, voting on proposals related to the completion of the internal market in the Council of Ministers shall be by qualified majority. This applies in all cases except for proposals regarding:

-- "Fiscal provisions..."

-- Provisions "relating to the free movement of persons..."

-- Provisions "relating to the rights and interests of employed persons."

Such proposals must be passed unanimously by the Council.

Per Article 148 a "qualified majority" means at least 54 out of 76 votes -- the votes of member states being weighted according to the following formula:

France	10 votes
Germany	10
Italy	10
United Kingdom	10
Spain	8
Belgium	5
Greece	5
Netherlands	5
Portugal	5
Denmark	3
Ireland	3
Luxembourg	2

Appendix III

The New EC Approach to Harmonization of Standards and Certification

By Patrick W. Cooke and Donald R. Mackay
Office of Standards Code and Information
National Bureau of Standards

Most EC Member States have their own standards which set health, safety and quality requirements for goods sold in their national markets. When those national standards differ, or when product standards, testing and certification procedures are not recognized from country-to-country, technical barriers to trade can result. Producers who wish to market their products in more than one country are often forced to have their products tested and certified several different times. Products must often be modified to meet each country's standards. This is expensive and discourages the marketing of products internationally.

The European Community plans to have, by the end of 1992, harmonized EC-wide standards, and procedures for testing and certification that will allow all products that comply with EC standards to freely circulate within the European Community.

The EC's "New Approach" to Standards

To achieve EC-wide standards, as well as EC-recognized testing and certification procedures, the European Community has adopted a "New Approach" intended to overcome delays inherent in the process of revising thousands of highly technical and differing national standards.

Under the EC's "New Approach," EC Directives promulgated by the European Community are limited to defining "essential requirements" for protection of health, safety, the environment and, in some cases, industrial policy concerns. The task of establishing the technical standards for these essential EC requirements will be taken on by the non-governmental European standardization bodies, such as the Committee for European Standardization (CEN) and the Committee for European Electrotechnical Standardization (CENELEC).

Where national product standards already exist, these regional standards bodies will seek to harmonize them. In the absence of existing standards, the regional standards bodies intend to develop European standards based on international standards developed by such groups as the International Organization for Standardization (ISO) and the International Electrotechnical Commission (IEC). Alternatively, individual EC Member States may adopt appropriate standards to satisfy the established health, safety, and environmental requirements.

This process of producing several hundred new "harmonized" European Standards may take years. In the meantime, the European Community's program to achieve the free circulation of goods and services within the EC's internal market is not to be delayed. Once the harmonized, EC-wide "essential requirements" have been met, EC Member States will be obliged to recognize the adequacy of each others' national standards for non-essential characteristics. More importantly, for products where no EC-wide directive exists, Member States will also be obliged to recognize each others' national standards.

U.S. Standardization Concerns

The EC legislation dealing with standardization is likely to have a profound effect on U.S. exports, because harmonized standards may inadvertently be framed so as to hinder the market access of U.S. products. Equally important, products imported from the European Community may be more competitive due to the harmonized standards and the economies European companies will experience as a result.

Currently, U.S. exporters are not given the opportunity to review and comment on proposed EC standards during the initial development phase, i.e., before they are issued for voting within CEN and CENELEC. This prevents U.S. companies and standards organizations from reviewing EC proposals at a time when their comments are likely to be persuasive. Draft European standards issued by CEN and draft specifications issued by the Electronic Components Committee (CECC) of CENELEC "for formal voting" are available from the American National Standards Institute (1430 Broadway, New York, N.Y. 10018; tel. 212-642-4900).

Although the European Community claims that the GATT Standards Code does not oblige signatories to publish proposed EC standards when they are first notified to the EC Member States and their industry associations, the United States Government and industry have sought opportunities to review and comment on some early draft EC directives before they are "set in concrete."

EC Testing and Certification

Once EC-wide standards are agreed upon, two further technical steps may be required in order to market a product in Europe: 1) product testing to assure conformance to the EC-wide standard; and 2) assurance that the testing has been conducted correctly.

The European Community is now attempting to develop a sectoral approach to the mutual recognition of test data and certification procedures for products destined to circulate within the European Community. The intent is to avoid the wasteful duplication of effort in product approvals.

This initiative will involve the preparation of common conditions and codes of practice for implementation by national testing laboratories and certification bodies in the European Community. It will most probably lead to agreements for reciprocal recognition of national laboratory accreditation programs.

Recent statements by European Community officials indicate realization of an immediate need to establish a harmonized approach to testing and certification. Their sense is that without these additional initiatives, harmonized standards will not guarantee the free circulation of goods throughout the Community. The EC Commission proposes to meet this need by establishing an institution for certification and testing that will deal with both voluntary and mandatory declarations of conformity. This new EC institution would establish criteria leading to the mutual recognition of conformity marks, particularly among EC members and between the EC and EFTA* countries.

The EC Commission's informal proposal for this institution would make it completely independent of any existing regional or national standards body although all those standards bodies would be given a role in establishing EC priorities regarding testing and certification.

Conclusion

The European Community is proceeding aggressively with plans to harmonize differing national standards and testing and certification procedures into a single EC-wide body of uniform standards and regulations. This can offer real advantages to U.S. businesspeople interested in a large market for their goods. A U.S. product that meets the EC requirements in one Member State will then be free to be marketed throughout the European Community.

*** The Member States of the European Free Trade Association (EFTA) include Austria, Finland, Iceland, Norway, Sweden and Switzerland.**

APPENDIX IV

SOURCES OF FURTHER INFORMATION

The following is a brief guide to further sources of information, including both published sources and offices where contacts may be made for more details on specific issues than is provided in this paper. It is intended to assist business persons who read this report, and is not a comprehensive bibliography.

European Community Official Sources

The major U.S. source of documents and information on EC-92 is the European Commission's office in Washington. The address is:

Delegation of the Commission of the European Communities
2100 M St. NW, Suite 707
Washington, DC 20037
(Tel. 202/862-9500)

The E.C. also maintains offices in New York and San Francisco.

Some basic E.C. documents that have been used in preparing this report are:

Completing the Internal Market: White Paper from the Commission to the European Council (Commission of the European Communities, June 1985).

Completing the Internal Market: The Progress Report Required by Article 8b of the Single European Act (Commission of the European Communities, November 3, 1988)

(DG III in Brussels also compiles periodic updates of all internal market directives that have been adopted. The most recent list is dated October 31, 1988.)

There are two Commission publications summarizing the economic background of the EC-92 program and the results of the full 35-volume E.C. study on the "costs of non-Europe." The briefer policy summary, designed for the business reader, is:

Paolo Cecchini, et al., The European Challenge -- 1992: The Benefits of a Single Market (published for the Commission of the European Communities, 1988; U.S. distributor -- Gower Publishing Co., Brookfield, VT), 125 pp.

A more comprehensive and formal summary of the findings is:

Michael Emerson, et al., The Economics of 1992, issued as European Economy, no. 35 (Commission of the European Communities, March 1988), 222 pp.

Appendix IV (Cont.)

On technical standards, the basic framework is outlined in:

Florence Nicolas, Common Standards for Enterprises (Commission of the European Communities, 1988), 79 pp.

The full Treaty of Rome, as amended by the Single European Act, is published in:

Treaties Establishing the European Communities, abridged ed. (Office of the Official Publications of the European Communities, 1987), 649 pp.

U.S. Government Official Sources

The International Trade Administration of the Department of Commerce maintains a comprehensive list of all proposed and adopted measures relating to EC-92. This information, with more detailed follow-up information on specific issues, can be obtained from:

Single Internal Market: 1992 Information Service
Office of European Community Affairs
U.S. Department of Commerce -- Room 3036
14th St. and Constitution Ave. NW
Washington, DC 20230
(Tel. 202/377-5276)

U.S. business visitors to Brussels should contact:

U.S. Mission to the European Communities
Blvd. du Regent 40
Brussels, Belgium
(Tel. from U.S. 322/513-3830)

See also the following U.S. government analyses:

Department of State, Bureau of European and Canadian Affairs, The European Community's Program To Complete a Single Market by 1992 (July 1988).

Glennon J. Harrison, The European Community's 1992 Plan: An Overview of the Proposed "Single Market", Congressional Research Service report no. 88-623 E (September 1988)

Office of the U.S. Trade Representative, Completion of the European Community Internal Market: An Initial Assessment of Certain Economic Policy Issues Raised by Aspects of the EC's Program (December 1988).

Appendix IV (Cont.)

Private Sector Sources

The best and most comprehensive study of EC-92, with specific references to effects of major proposals on U.S. economic interests is:

Michael Calingaert, The 1992 Challenge from Europe: Development of the European Community's Internal Market (Washington: National Planning Association, 1988), 148 pp.

The most comprehensive and current information on specific EC-92 developments is provided by the E.C. Committee of the American Chamber of Commerce in Belgium. AmCham publications are available for sale to non-members. A particularly useful and concise guide, that is periodically updated, is:

Business Guide to EC Initiatives, E.C. Committee of the American Chamber of Commerce in Belgium (latest ed. - Autumn 1988), 86 pp.

For copies of this guide and information on other AmCham material, contact:

American Chamber of Commerce in Belgium
E.C. Affairs Office
Ave. des Arts 50, Bte. 5
B-1040 Brussels, Belgium
(Tel. from U.S. 322/513-6892)

Representative HAMILTON. Mr. Horlick, please proceed.

STATEMENT OF GARY N. HORLICK, PARTNER, LAW FIRM OF O'MELVENY & MYERS, ON BEHALF OF THE U.S. CHAMBER OF COMMERCE

Mr. HORLICK. Thank you, Mr. Chairman.

For the record my name is Gary Horlick. I am a partner in the law firm of O'Melveny & Myers. I'm pleased to appear here on behalf of the U.S. Chamber of Commerce. I am a member of the Chamber's International Policy Committee and its EC–1992 Subcommittee. I should state that this testimony is not necessarily the position one way or another of my law firm, and answers to questions are totally my personal responsibility.

Essentially, the Chamber's position can be summarized as cautious optimism. We view EC–1992 as positive, and something that is likely to be good for U.S. businesses. But at the same time, while we are optimistic, there is caution, as Steve said, also.

So far historically, EC unification and integration, economically since the 1950's have been good for the United States, but there have been problems in specific areas, and agriculture is an obvious example. Some EC actions, which I will mention, have affected some U.S. businesses negatively and it's something we view with concern.

That said, it's very clear to us that the European companies that wish to become world class competitors are well aware that they need a free and open market worldwide and, consequently, we see many voices in the EC, such as the German Industry Association, holding forth against protection in favor of a competitive marketplace because they know that's what they need if they are going to be competitive.

The problems come up in ways that may not even be aimed at the United States, and that is really a major concern. It's not so much that we expect the EC to be going after the United States in a protectionist way, but it's that in an interdependent world, which we have economically now, "no man is an island," to quote another European.

A good example is a recent affair involving Japanese photocopiers. We are not taking sides on the merit of the case one way or another. If you look at it historically, because of the GATT the EC cannot simply impose high duties or quotas. That's what people used to do in the 1930's and 1940's and you can't do that.

The weapon of choice in the 1960's and 1970's became "voluntary restraint agreements." Well, the problem with that is that that can turn into a windfall for the exporter. So the EC didn't want to do that. It wound up with an antidumping duty on photocopiers from Japan, and we have already seen two impacts on the United States from that.

First, the EC has proposed to extend those duties to photocopiers made in California by a Japanese company and, second, the EC has extended those duties to Japanese photocopiers made in the EC. This gets a little complicated, but apparently the deal becomes that if the Japanese company in Europe agreed to use more European parts they would not have to pay the duty. What this means, it's reported, they quit buying U.S. semiconductors and started buying European semiconductors.

So, as I said, we are not taking a position on the merits, but the results are quite clear. You have more copiers assembled in Europe, less in Japan, less in the United States, and you have fewer semiconductor exports from the United States to Europe than you used to have.

We use this example because it's a very good example of how the international economy is now so interlinked that when you take one thread out you start unraveling threads in the rest of the fabric. I'm sure that the U.S. semiconductor producers never looked at this photocopier case as a threat to them until this started happening.

In terms of general principles, the Chamber's EC-1992 Subcommittee has developed a set of principles that we think will lead to an internal open market and benefit both Europeans and non-Europeans. We go through this in more detail in our prepared statement, but I would note them briefly.

First, economic welfare and social equity are enhanced by policies that encourage market-oriented, incentive-based economic activity.

[Lights in the hearing room go off.]

Mr. HORLICK. Well, some things are best done in the dark, but I don't think this one is.

Representative HAMILTON. If you can see, just go right ahead.

[The lights come back on.]

Mr. HORLICK. Second, open access to an integrated European market will foster economic dynamism in Europe and around the world.

Third, national treatment is the basis for cooperation and growth.

Fourth, support of an open world trading system.

Fifth, open and transparent EC rulemaking and enforcement procedures for both European and non-European parties.

Sixth, nondiscriminatory and timely enforcement of rules.

I should note, these principles are squarely based on the kinds of market-opening principles that are in the GATT. If the Europeans in integrating their market follow these principles, we think the United States will have little to worry about.

There are some specific issues I've mentioned which have already come up.

The first one, rules of origin, I have already mentioned how dealing with the origin of a photocopier from Japan could affect U.S. semiconductor exports to Europe.

Similarly, if you have a rule of origin on semiconductors, there is a clear pressure to invest in semiconductor production in Europe rather than in the United States, and that's already a possibility.

This question of rules of origin is not yet before the GATT. Apparently the United States is considering, according to USTR that it be dealt with in the Uruguay Round of trade negotiations. Rules of origin are horrendously complicated as a technical matter and are great fun for lawyers, but they are very important to businessmen, and until we have rules of origin, any non-European producer, including U.S. producers, has to face the possibility that a rule of origin could be changed in a way detrimental to their exports.

EC officials have claimed that some of these rulings arise really out of dumping cases aimed at Japan or newly industrializing countries. The problem is, this is true for a whole range of things. Once you change the rules in a way that permits a government to hit, say, at Japan, those same rules could be used against the U.S. companies in the future. So we place great stock on having rules and, indeed, this underlines the importance of the Uruguay Round of GATT negotiations. What you need are rules which bind everyone, including the EC, in ways that help open markets.

The next issue is government procurement. Historically a lot of the government procurement of the EC individual states has been closed, and the EC is proposing to open that up. Obviously this could be helpful. The danger is that a local content requirement would limit the opportunities for U.S. exporters.

I should note everyone lives in glass houses. We have "Buy America" provisions in the United States as well as in States and municipalities, again a good example of where rules that bind everyone would mean more opportunities for all exporters.

Another problem is labeled "transitional rules." A good example is in the automobile industry. A number of member states in the EC have quotas on automobiles, Japanese automobiles, with varying degrees of formality. Obviously if you get rid of all the customs barriers within the EC, you can't enforce a national quota. Italy has a quota I think of 3,000 cars, but if no one is standing at the French-Italian border you couldn't enforce it, and EC-1992 means no one will be standing there.

So the question becomes, will the EC instead have an EC-wide quota on Japanese cars and what does that mean for the United States? One of the fears of the United States has always been, and cars are a good example, if the EC puts quotas on Japanese cars, does that force the Japanese to export more here than they would have normally. So, again, it's an interdependent world.

I do note that a senior EC official has come out rather strongly against having Europe-wide quotas on automobiles. So, as I said at the beginning, we don't want to assume protectionism and, to the contrary, the EC has a lot of people internally who are fighting against that sort of thing.

Finally, the question of harmonization of product standards. This is again a very technical process, but one that is very important to businesses. There are some indications, and this is not conclusive, that non-EC businesses won't have the same access to the standards setting, and in particular there is concern about the testing and certification procedures.

Obviously, if you are a small business in the United States it may sound great to say you have the same theoretical rights, but if it's not easy to do, you're not gong to be able to export. This is a problem that the United States has addressed itself, and standard setting in the United States is on balance considered relatively open, but we are not perfect either.

Just to sum up, U.S. businesses have a variety of relationships with Europe. Some businesses export to Europe, some produce in Europe and some do both. The U.S. Government as it forms its policy toward Europe in 1992 has to take into account the fact that U.S. businesses have a wide variety of trading relationships with Europe, both export and investment.

That said, the Chamber of Commerce looks at an integrated European market as a real challenge and a real opportunity. It's going to be an opportunity because of the business possibilities in an integrated Europe, but it's also a challenge both to ensure access and because an integrated European market will spawn new and powerful competitors.

Thank you very much.

Representative HAMILTON. Thank you, Mr. Horlick.

[The prepared statement of Mr. Horlick, together with an attachment, follows:]

PREPARED STATEMENT OF GARY N. HORLICK

EUROPE-1992: TRADE AND INDUSTRIAL POLICY

Thank you, Mr. Chairman. I am Gary Horlick, a partner with the law firm of O'Melveny & Myers[1] here in Washington. I am pleased to be here today on behalf of the U.S. Chamber of Commerce as a member of the Chamber's EC-1992 Policy Subcommittee.

The prospect of a single European market in the 1990's -- the largest trading block in the world -- is an unrivaled challenge for U.S. business and government. A unified Europe will be a formidable competitor and a powerful ally.

The challenge posed by the European Communities' integration (EC-1992) must be approached with cautious optimism. Optimism is appropriate because of the potential opportunities afforded through unparalleled economies of scale and a $4 trillion economy with 320 million people. Caution is required because of the mixed signals emanating from the European Commission. On the one hand, we are promised access to a barrier-free internal market and, on the other, we see the price some are being charged for access -- bricks and mortar put down within the EC.

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[1] The views expressed herein are not necessarily the views of the law firm, O'Melveny & Myers.

Europe knows that it must maintain open competition and economic dynamism, if its original goal -- a prosperous, world-competitive economy -- is to be attained. European companies that wish to be world class competitors recognize the need for free and open markets worldwide. We should recognize that many voices in the EC oppose a future of protection for uncompetitive, import-sensitive European industries.

The European Community is currently the United States' largest trading partner, with total U.S.-EC trade and investment exceeding one trillion dollars (based on 1986 statistics, the most recent year for which comprehensive, complete data are available). Europe represents a significant market for such critical products as electronics, which last year totaled about $20 billion in U.S. exports.

My testimony today will address: (1) the background of EC-1992, (2) a set of general principles that must direct the U.S. view of EC-1992 -- principles, we believe, that will lead to the realization of the opportunities offered by a barrier0-free, single market; and (3) specific issues of concern to U.S. business. While there is still great uncertainty about the actual policy that Europe will adopt for the integrated market, recent actions have had an adverse effect on U.S. business.

Background

To understand the meaning of EC-1992, we must first understand its background. Trade and industrial policy for EC-1992 will be driven by the lingering fear of "Eurosclerosis" and the knowledge that European productivity lags significantly behind the U.S. and Japan in some sectors. In automobile manufacturing, for example, European productivity lags as much as 35 percent behind that of the U.S. and 88 percent behind Japan.[2] As the internal barriers are removed, there will be increased pressure on the European Community to maintain protection for selected industries while trying to create European champions that can be competitive on a world-scale. This will almost inevitably affect the U.S., even if not aimed at it.

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[2] John F. Krafcik, Research Associate, International Motor Vehicle Program, MIT, Testimony before Subcommittees on Europe and the Middle East and International Economic Policy and Trade, House Committee on Foreign Affairs, March 24, 1989.

A good example can be seen in the EC's complicated attempts to impose duties on Japanese photocopiers. The General Agreement on Tariffs and Trade -- the GATT -- precludes the traditional high tariffs or stringent quotas of the 1930's or 40's. Forcing Japan into a "voluntary" export restraint -- the "weapon of choice" of the 1960's and 70's -- would make no sense, because its effect could be to give the Japanese photocopier exporters windfall profits with which to invest in new equipment or more research and development. Consequently, the EC has increasingly used its antidumping law as the primary instrument of import policy, and an antidumping duty was soon imposed on photocopiers from Japan. This has already affected the U.S. in two ways:

(1) The EC Commission has proposed that duties on Japanese copiers be extended to include photocopiers shipped from a plant in California owned by a Japanese company; and

(2) The EC has also extended the duties to cover photocopiers assembled in Europe by Japanese producers from imported components. The EC reportedly agreed to drop the duties if the Japanese assemblers in Europe agreed to use EC components. The result --Japanese assembly plants in Europe replaced U.S.-made semiconductors with EC semiconductors.

To summarize: more copier assembly in Europe, less in Japan and the U.S., and fewer semiconductor exports from the U.S. to Europe.

Principles

The Chamber's Policy Subcommittee on EC-1992, of which I am a member, has developed a set of principles that we believe, if upheld, will lead to an open internal market that will benefit European and non-European exporters alike. The principles, which are outlined in more detail in Attachment 1, are:

(1) Economic welfare and social equity are enhanced by policies that encourage market-oriented, incentive-based economic activity;

(2) Open access to an integrated European market will foster economic dynamism in Europe and around the world;

(3) National treatment is the basis for cooperation and growth;

(4) Support of an open world trading system;

(5) Open and transparent EC rule-making and enforcement procedures for both European and non-European parties; and

(6) Nondiscriminatory and timely enforcement of rules.

These principles are squarely based on the market-opening and market-expanding policies of GATT. Consequently, if the Europeans adhere to these principles as they form an integrated market, the United States will have little about which to be concerned.

Specific Issues

As the European Community works toward an integrated, internal market, due consideration should be given to certain key issues that U.S. business perceives to be fundamental to business interests worldwide. These issues are: (1) rules of origin and local content; (2) government procurement; (3) transitional rules; and (4) harmonization of EC product standards.

Rules of Origin and Local Content

The first issue of concern is local content requirements and rule of origin. Rules of origin only come up in international trade when discriminatory trade measures are being applied, such as preferential tariff rates, antidumping and countervailing measures, or country-specific quotas or licensing requirements.

The EC's general rule determines that origin is based on the "country in which the last substantial process of operation that is economically justified was performed." This general rule has recently been supplemented with some product-specific rules. The most dramatic example of the negative effect such rulings can have is the recent EC ruling on semiconductors. This ruling, in effect, requires that the sophisticated and expensive process of "diffusion" be conducted in Europe, even if it is not the last economically justifiable operation. This ruling increases pressure to invest in costly production facilities in Europe rather than the United States. Currently, very few U.S. semiconductor manufacturers have facilities in Europe. However, recent press reports indicate that some U.S. semiconductor manufacturers have announced plans to build such facilities in Europe.

Although there is no GATT standard for rules of origin, the United States may proposed in the Uruguay Round the negotiation of such a standard. Until this happens, non-European producers will face increased costs of doing business, either through higher duties or shifting of manufacturing facilities to the EC.

Content requirements have been used recently by the Europeans to prevent the alleged circumvention of dumping laws through "screwdriver" assembly plants. The Japanese maintained that their products were European because they were "assembled" in Europe. To counter this, the EC established the screwdriver assembly regulations that allow EC origin if products have reduced Japanese content. Content requirements can displace traditional non-EC parts suppliers, such as the United States, as producers hustle to fulfill the perceived need for local content.

EC officials claim that these rulings arise out of particular dumping cases involving the Japanese and the Newly Industrializing Countries (NICs). As a result, the EC maintains that these actions should not alarm the U.S. because they are clearly aimed at Japan and the NICs. Nevertheless, once rules have been changed to hit Japan or the NICs, those same rules can be applied to U.S. exporters, both directly and indirectly.

Government Procurement

Much of the $600 billion annual EC public procurement market has long been closed at the level of individual EC member nations. Commission directives have been proposed that would attempt to open those markets, but they impose a 50 percent local content requirement for non-EC firms as well as a mandatory 3 percent bidding price premium for EC companies. (It should be borne in mind that some U.S. states and municipalities impose "Buy-American" requirements.)

Transitional Rules

As internal barriers are removed, the EC will likely act to protect sensitive industries that will face intensive competition and adjustment problems. There will be a temptation to transfer those costs outside the EC. In fact, it is stated EC policy to shield certain sectors; however, there is little specificity as to where or for how long such transitional rules (i.e., temporary protection) will be applied.

Harmonization of EC Product Standards

U.S. manufacturers stand to gain much from the development of a single product standard rather than 12 individual diverse and often conflicting standards. But the process could be used to create effective non-tariff barriers for non-EC companies. There are some indications that non-EC parties will not be permitted to participate directly in the EC standards setting process, nor will they have rights to redress grievances. This is asymmetrical with the U.S. process. More than the product standards themselves, U.S. manufacturers are particularly concerned about the testing and certification procedures through which standards are implemented.

Conclusion

When the specific issues of concern are addressed, almost everyone treats these concerns as though U.S. business is affected homogeneously. In fact, this is not so. U.S. firms are affected according to their respective trading relationship to Europe. Some firms have a manufacturing presence in Europe, some directly export to Europe, and some companies do both. Within each of these categories, there are both large multinationals and small businesses, each affected differently as well. The United States' strategy must account for these differing interests. Nonetheless, the magnitude of the changes will be so significant that all U.S. businesses, regardless of their trade relationship with Europe, will be affected. Consequently, we cannot adopt a "wait-and-see" attitude unless we are willing to face serious distortions of market-based trade and investment. A unified Europe will offer opportunity and challenge for U.S. business and government -- challenge not only to ensure access, but challenge also to meet a new and powerful competitor.

Attachment

A United States Private Sector Agenda for the European Community Internal Market

Issued by the EC 1992 Policy Subcommittee
of the
United States Chamber of Commerce

February, 1989

Economic Freedom as the Foundation for Social Welfare

1. We believe that progress in meeting human needs and achieving social equity is greatly enhanced by policies which encourage incentive–based, market–oriented economic activity, and which promote the free and unencumbered flow of trade and investment.

   Conversely, we believe that policies which constrain economic liberalism or which employ market distortions as a means to achieve short–term objectives are ultimately counterproductive.

   Therefore, in defining the regulatory and legal parameters of Europe's integrated market, we urge conformity to principles of free and open markets.

Economic Dynamism Through Open Markets

2. We reject any supposition that Europe's gains can be achieved only or largely at others' expense. We hold the opposite to be true — an integrated European market which affords open access by non–EC parties is an essential ingredient in the EC effort to foster European economic dynamism. Such a market will benefit EC and non–EC nations alike.

National Treatment as the Basis for Cooperation and Growth

3. We urge EC leaders to attach primacy to the principle of "national treatment", that is, that all nations accord the same standards and privileges to foreign firms that they accord to their own nationals. Embodied in OECD conventions, national treatment assures parity of treatment for all parties within market blocks while allowing preservation of legal and regulatory practices grounded in their individual cultures and socioeconomic traditions.

   We reject the notion that access to the EC internal market should be used as a "bargaining chip" on a sectorally reciprocal basis with non–EC nations in matters affecting rights of establishment and acquisition, provision of services, or market access for traded goods.

EC Encouragement of Open World Trading System

4. We urge the EC to construct the internal market in a manner which supports and encourages further global economic integration and continued development of an open world trading system.

Fair Rules, Open Procedures

5. We believe that the interests of both the European Community and its trading partners will be best served if deliberations surrounding EC rule–making and enforcement are conducted transparently and with open access to non–EC parties. Such procedures will foster informed public scrutiny and permit effective representation of the legitimate interests of all affected parties in critically important areas such as public procurement policy and equitable development and application of product standards.

Effective, Non–Discriminatory Enforcement of Rules

6. We submit that effective and timely enforcement of EC directives, regulations and judicial decisions which comport with these principles is essential to the success of the European internal market and constitutes a necessary safeguard against discriminatory injury to parties within and outside the European Community.

Representative HAMILTON. Mr. O'Cleireacain, please proceed.

STATEMENT OF SEAMUS O'CLEIREACAIN, DIRECTOR OF SEMINARS ON UNITED STATES-EUROPEAN COMMUNITY RELATIONS, INSTITUTE ON WESTERN EUROPE, COLUMBIA UNIVERSITY; AND ASSOCIATE PROFESSOR OF ECONOMICS, STATE UNIVERSITY OF NEW YORK AT PURCHASE

Mr. O'CLEIREACAIN. Thank you, Mr. Chairman.

I'm Seamus O'Cleireacain, associate professor of economics at the State University of New York at Purchase. I teach the course on the European Community at the Economics Department at Columbia University, and I'm the director of the seminars on United States-European Community relations at the Institute on Western Europe at Columbia.

The EC's 1992 program and the further loss of sovereignty that it entails is a major force remaking the face of Western Europe and also Eastern Europe. Forty-year-old arrangements put in place after Yalta are disappearing and there are major implications for the United States.

I would like to spend my time looking at two main topics, the possible long-term trade and other effects on the United States and the present diversity of EC member-state policies.

Looking first at the long-term trade effects, I share Mr. Cooney's optimism on Fortress Europe. In my personal opinion, there is not too much likelihood of Fortress Europe and I can point to four obvious reasons why that won't happen.

In the first place, the potential gains which have excited Europeans are gains that come from trade liberalization. Even with unemployment averaging over 11¼ percent Europeans are willing to engage in policies that will cost jobs in the short run.

No. 2, U.S. corporations exporting from the United States or with production facilities in Western Europe will find that it is easier to do business in the Community as the existing maze of national technical standards are harmonized and 12 differing standards become functionally equivalent. This will allow U.S. corporations to pick the most convenient of these 12 standards and gain entry to an EC-wide market.

U.S. multinationals are well situated to take advantage of the opportunities. U.S. direct investment in the EC exceeds $120 billion, and the manufacturing sales of EC subsidiaries of U.S. corporations exceed $400 billion annually, eight times the value of U.S. manufactured exports to the Community. U.S. subsidiaries may be expected to share the same market opening opportunities as their European competitors.

Major opportunities exist also for small U.S. firms which may have shied away from exporting to the Community in the past because, unlike multinationals, they lacked the resources to service 12 different member-state markets at once.

So while greater EC competitiveness may produce detrimental effects on some U.S. exports in some sectors, the gain to EC subsidiaries of U.S. corporations together with new export opportunities for smaller U.S. firms should exceed any losses. Even if all gains not remitted to the United States don't improve the U.S. current account, the gains will help reduce the present net debtor position of the United States.

No. 3, there appears to be a generally antiprotectionist majority in the EC's decisionmaking process. As you know, the Community's Council of Ministers uses a weighted voting system in making most 1992 decisions. Some member-states have a long tradition of leadership in helping to maintain an open trading system and others have a greater penchant for state intervention and for protectionism. Without identifying countries by name, it's possible to argue that generally there are not enough votes to carry a protectionist position in the Council of Ministers.

No. 4, in its program to date, EC actions appear to have been compatible with existing GATT rules and with its own negotiating strategy in the Uruguay Round negotiations. The happy coincidence in timing between the Uruguay Round and the 1992 program provides opportunities for the United States and other EC trading partners to influence some 1992 outcomes, particularly in areas such as standards and government procurement.

While the 1992 program is unlikely to produce a Fortress Europe, there are clear areas in which future trade tensions may erupt between the EC and its trading partners.

As Mr. Horlick has mentioned, country of origin determinations are one such area. Recent country of origin rulings unrelated to 1992 give some indication of what's likely to happen in areas such as government procurement. Japan rather than the United States would appear to be the main target in most of these determinations.

The EC's own estimates of the trade effects of the 1992 program show a worsening of the current account balances of the EC's trading partners by about 1 percent of EC GDP 6 years after completion of the internal market.

The trade impact on the United States would be greatest in industries which constitute a significant proportion of U.S. exports and in which European producers can expect to achieve significant economies of scale. The impact on the United States would also depend on the extent to which real competition flourishes in European markets and will be greater if a combination of EC corporate strategy and antitrust policy eliminates price disparities between EC member-states.

The high end of the range of estimates under the most adverse conditions for the EC's trading partners includes declines in EC imports of office machinery of 68 percent, motor vehicles 61 percent, artificial fibers 58 percent, footwear 35 percent, carpets 24 percent, and electrical household appliances 24 percent. With the exception of office machinery, most of the products covered in this selected list are not among the major U.S. exports to the EC. Japan and a number of newly industrializing countries are likely to be more directly impacted.

However, the 1987 total of 48 billion dollars' worth of U.S. manufactured exports to the Community included $8.5 billion in office and automatic data processing machines and parts. A potential 68 percent decline in U.S. exports in this category would amount to a 12-percent decline in total U.S. manufactured exports to the Community, a serious loss to the United States. It should be stressed, however, that the conditions necessary to produce such a loss, such a high end of the range of estimates is, in my view, rather remote.

There are other areas in which the 1992 program may be expected to have an indirect impact on the United States. There exists some possible emergence of a social dimension of 1992. Examples include a 1975 collective redundancies directive, which is an EC-wide plant closing law requiring a minimum of 30 days' advanced notification of mass redundancies; a draft European company statute which requires worker participation in decisionmaking; and a draft merger and acquisition directive which also calls for worker participation. U.S. multinationals which accept a social dimension as an ingredient of operating plants in Europe are likely to find their U.S. employees insisting on similar arrangements in the United States.

Let me take a moment on the diversity of EC member-state trade policies. The European Community is no single-minded juggernaut, centrally controlled from Brussels. Even after 1992, very considerable powers will remain in the hands of member-state governments. These governments range across the political spectrum from laissez-faire governments to socialist governments. In the trade field, the 1992 program will require an end to some present disparities in the commercial policies of member-states.

EC member-state deviations from the common commercial policy have always required approval from Brussels. Under article 115 of the Treaty of Rome, member-states may presently seek EC permission to introduce protection against other member-states to prevent non-EC imports it restricts from being deflected from elsewhere in the Community. Some 100 to 200 such article 115 authorizations are made each year, the vast bulk of them in textiles.

Article 115 authorized restrictions are incompatible with a single market and will have to disappear under the 1992 program. It's not yet clear how this final harmonization of member-state protection is to be achieved. There is some likelihood that Japan rather than the United States may have a more difficult time with any EC-wide transitional measures which are introduced.

In the case of cars, there has been considerable jockeying as the Commission considers how the gaps in the common external policy may be closed to ensure an internal car market after 1992. The Italian voluntary export restriction on Japanese cars has already been mentioned. I discuss the member-state voluntary export restrictions in more detail in my prepared statement.

It should be noted that the Commission this year has forced Italy to accept an additional 12,000 Japanese cars from other EC member-states as part of the process of phasing out these article 115 authorizations.

Some future trade friction involving U.S. manufacturing exports to the Community may involve Japanese rather than U.S. corporations. Honda plans to export from its Ohio plant to the EC in 1991. There is always the possibility that the EC will seek EC-wide auto VER's with auto exporting nations which could include the United States. Alternatively, nondiscriminatory temporary protection under GATT article 19 could be involved.

The Ricoh case has already been discussed by Mr. Horlick, and I discuss it in more detail in my prepared statement. It's worth pointing out that in the Ricoh case a company which has been accused of dumping in the Community market faces antidumping duties not just on its exports from Japan but also on its exports from California. In the Ricoh case a product deemed sufficiently American in origin to qualify for the Buy American Act was deemed by the EC to be not sufficiently American in origin to escape antidumping duties.

These two examples suggest that, in eliminating existing disparities between member-state commercial policies, the 1992 program may provoke further instances in which the U.S. Trade Representative is called upon to ensure EC market access not only for U.S. corporations, but also for Japanese-owned plants located in the United States.

Let me stop at that point, Mr. Chairman.

Thank you very much.

[The prepared statement of Mr. O'Cleireacain, together with an attachment, follows:]

PREPARED STATEMENT OF SEAMUS O'CLEIREACAIN

Long-Term Implications of Europe 1992 for the US Economy

Mr. Chairman, thank you for the opportunity to address the committee on the implications of Europe 1992 for the US. I have already provided your staff with a number of other papers of mine on various aspects of the EC's program, and I appreciate the opportunity to address you in person.

The EC's undertaking is of great significance for the US. As the Commission of the European Community itself admits, the program to complete its internal market is expected to have net negative effects on the EC's trading partners. Some of these effects are likely to be felt by the US, although other countries, such as Japan, appear to be more obvious targets of EC policies. The manner in which the internal market is completed will provide an indication of the EC's real intentions toward the principle of an open world trading system.

The geopolitical significance of the 1992 program also deserves mention. The creation of an EC-wide economy is part of a wider, incomplete, political enterprise of great strategic importance to the US. The present European attempt to complete the EC's internal market involves an objective which the original six Rome Treaty signatories had sought to achieve by 1970. In the case of the EC, economics is a means to a political end. The end is still the subject of dispute. Whether Europe is on the road to a United States of Europe or a loose federation of members retaining extreme "states' rights" is still unclear. The process began with the signing of the Treaty of Paris, establishing the European Coal and Steel Community, in 1951. In comparison to the time-span of the creation of the United States of America, the calendar has moved forward from 1776 to 1814.

My remarks today will fall under three general headings:

I The possible long-term trade and other effects on the US.

II The present diversity of EC member-state trade policies.

III The political role of the European Community in a wider Europe.

I. Possible Long-term Trade and Investment Effects

A. Fortress Europe?

Let me begin by expressing a personal opinion that there is little likelihood that the EC's efforts to complete its internal market will produce a Fortress Europe. However, even without the erection of a protectionist Fortress Europe, there will be trade effects produced by the 1992 program, and some of them may be expected to be detrimental to the US. These effects would occur even without any increase in EC protection. Absent offsetting influences, such as exchange-rate movements, any policy which lowers production costs and makes an economy more competitive should be expected to improve that economy's trade balance to the detriment of its trading partners. The origins of the 1992 program may be traced back to a realization that, to compete with the US and Japan, Europe needed a large domestic market, which, by permitting cost-cutting economies of scale, would produce a platform from which to compete in world markets.

A number of reasons may be advanced to support the conclusion that the 1992 program should not be viewed as an effort to erect a Fortress Europe.

1) The potential gains which have excited Europeans are gains from trade liberalization. In approach, the 1992 program is generally deregulatory and anti-interventionist. The potential gains from the 1992 program do not come at the expense of outsiders, but will require plant-closings in Europe, costing jobs in the short-run. Europeans appear prepared to bear these short-term costs despite the fact that, in 1988, average EC unemployment rate was 11.25%, six of the twelve countries had double-digit unemployment, and no country had yet managed to get its unemployment rate back down to pre-1973 oil-shock levels.

2) The past protectionist record of the EC is rather similar to that of the US. We are all sinners. Based on 1986 data, 13% of EC imports from developed countries and 23% of imports from developing countries were subject to "hard-core" non-tariff barriers.[1] The comparable figures for the US were 15% and 17% and, for Japan 29% and 22%. The US would appear to be slightly more protectionist than the EC in its treatment of other developed countries, while the EC appears more protectionist than the US in the treatment of developing countries.

3) US multinationals are well situated to take advantage of the coming single market. The major disruptions within EC

industry are likely to occur among small and medium-size enterprises. US corporations have long viewed the continent as one economic space and have been more "European" than many European corporations. US corporations, exporting from the US or with production facilities in Western Europe, will find that it is easier to do business in the EC as the existing maze of national technical standards is harmonized. Major opportunities exist for smaller US firms which have shied away from exporting in the past because they lacked the resources to service twelve national member-state markets.

Harmonization of technical standards requires either uniformity of standards, through changing national standards to conform to one centralized standard, or reciprocity in acceptance of differing national standards. The EC's recently approved Machinery Directive, for example, demonstrates the EC's sweeping, fast-track "New Approach" to harmonization. Twelve differing national standards will be considered functionally equivalent as long as they contain certain agreed-upon essential ingredients, rather than all detailed specifications. US corporations (and of course, all others) will be able to pick the most convenient of 12 member state standards and be assured of free entry to all twelve member-states. Of course, it will still be necessary for the US to guard against the deliberate use of technical standards as non-tariff barriers (NTBs).

4) There appears to be a generally anti-protectionist majority in the EC's decision-making process. As you know, the

EC's Council of Ministers uses a weighted voting system in making most, though not all, 1992 decisions.[2] The four larger member-states (France, Germany, Italy and the UK) have ten votes each, Spain eight, Belgium, Greece, the Netherlands and Portugal five each, Denmark and Ireland three, and Luxembourg two. Fifty four votes constitutes a majority, although in some cases at least eight members must be included in the fifty four. Some member states have a long tradition of leadership in helping to maintain an open global trading system. Others have a greater penchant for state intervention and for protectionism. Without identifying countries by name, it is possible to argue that generally, there are not enough votes to carry a protectionist position in the Council of Ministers.

5) In its program to date, EC actions appear to have been compatible with existing GATT rules and with its own negotiating position in GATT negotiations. A number of directives drafted by the Commission for consideration and action by the European Parliament and the Council of Ministers also reflect the Community's negotiating stance in Uruguay Round bargaining. To some degree, the process of determining the future shape of Europe is coincident with the GATT Uruguay Round, due for completion in 1990. The happy coincidence in timing between the Uruguay Round and the 1992 program provides opportunities for the US and other EC trading partners to influence some 1992 outcomes. An obvious instance is the EC's draft second banking directive. The uncertainty over the manner in which reciprocal treatment was

to be afforded foreign banks has been clarified with the Commission's announcement that reciprocity should be based on "national treatment", as the US had sought, or on effective market access.

While the 1992 program is unlikely to produce a Fortress Europe, there are clear areas in which future trade tensions may erupt between the EC and its trading partners. Recent EC country-of-origin rulings suggest that global corporate strategies in which the production of some product lines is concentrated in the EC to serve both EC and world markets while the EC market for other product lines is served from plants outside the EC, will be threatened. The threat is limited by the GATT, but may be made good if producers are found guilty of unfair trade practices such as dumping or, under Article XIX, are subjected to temporary restrictions through the safeguards clause. Depending on the outcome of the Uruguay Round negotiations, US and other non-EC corporations doing business in Europe may find themselves excluded from some of the benefits of the internal market if the output of their EC plants is not considered "European" enough to qualify for EC-wide government procurement programs.

B. Likely Negative Trade Impacts on the US.

As you know, the EC Commission's own estimates of the trade effects of the 1992 program show a worsening of the current account balances of the EC's trading partners by about 1% of EC GDP, six years after completion of the internal market.[3] In the absence of further exchange rate changes, the increased competitiveness of the European economy will affect both sides of the trade balances of EC trading partners. Not only will lower EC costs make it more difficult to export to the EC, EC exports to the US and to third-country markets may be expected to rise.

Estimates of the direct effects of reducing intra-EC trade barriers include a fall in extra-EC imports by a little more than 2%, with the largest drop (7.8%), occurring in agricultural machinery.[4] Estimates of the trade impact of reduced production costs include a further drop in total extra-EC imports of between 5.7 and 7.7%, including a 61% decline in imports of credit and insurance services, 31% in communications services, 10% in chemicals.

The trade impact on the US will be greatest in industries which constitute a significant fraction of US exports and in which the European can enjoy significant potential economies of scale. The impact on the US will also depend on the extent to which real competition flourishes in European markets and will be greater if a combination of EC corporate strategy and anti-trust policy eliminates price disparities between EC member-states to produce a truly integrated market. The highest estimates of the potential declines in EC imports include declines in EC imports of office machinery of 66-68%; motor vehicles 41-61%; artificial fibers 48-58%; footwear 25-35%; carpets 20-24%; and electrical household appliances 24%.[5]

With the exception of office machinery, most of the products covered in this selected list are not among the major US exports to the EC. Japan and a number of NICs are likely to be more directly impacted than the US. However, the 1987 total of $47.9 billion in US manufactured exports to the EC included $8.5 billion in ADP machines and parts for office and ADP machines. A potential 68% decline in US exports of ADP and other office machinery would amount to a 12% decline in total US manufactured exports to the EC, a serious loss to the US. It should be stressed that the conditions necessary to produce such a loss are, at present, rather remote. As already mentioned, these conditions include full integration of markets, considerable economies of scale, sufficiently vigorous competition to end price discrimination and an equal reduction in EC imports from all sources.

C. Other Effects

There are other areas in which the 1992 program may be expected to have an indirect impact on the US. These include any movement toward monetary union, as advocated most recently by the

Delors Committee Report, as well as the so-called Social Dimension of 1992.

Monetary union is quite separate from the proposals for completing the internal market, although the establishment of an internal financial market is one of the preconditions necessary for any later monetary union. There is no obvious immediate impact on the US. Any future ECU displacement of the dollar as a unit of accounting, as a reserve asset, or in private portfolios would further limit US monetary and exchange-rate policy and would make it more difficult for the US to use the world's capital markets as a source of financing of budget or current account deficits.

The possible emergence of a "Social Dimension" to the 1992 program would also have long-term implications, not only for US corporations doing business within the EC but also, perhaps, within the US. The business community's opposition to any elaborate social dimension ensures that it remains a remote possibility but it should not be completely discounted. The EC's 1975 collective redundancies directive is an EC-wide plant-closing law requiring a minimum of 30 days advance notification of mass-redundancies.[6] A draft European Company Statute requires worker-participation in decision-making through either: a German-style worker representation on boards of directors; a Franco-Italian model of enterprise committees; or a Swedish-style co-management approach of company-specific arrangements. There is no zero-option. A draft mergers and acquisition directive also calls for worker-participation. American workers who see their own employers participating in such forms of corporate decision-making for European-based operations may be expected to insist on similar arrangements in the US.

II The Diversity of EC Member-State Trade Policies

The European Community is no single-minded juggernaut, centrally controlled from Brussels. Even after 1992, very considerable powers will remain in the hands of member-state governments. These governments include laissez-faire governments as well as socialist governments. They have widely differing interests and concerns. When Europe goes to the polls in June to elect the next European Parliament, it will be electing representatives of an even wider political spectrum than is represented in the US Congress. Even the recent Delors Committee Report recognized that after attaining economic and monetary union, "the Community would continue to consist of individual nations with differing economic, social, cultural and political characteristics".[7]

Regional disparities within the EC are considerably greater than found in the US. The 1983 ratio between real income per head in the ten poorest and the ten richest US states was 1:1.5; the ratio between their unemployment rates was 2.1:1. The income disparities in comparable regions of the twelve member-states was 1:2.4, while the unemployment disparities were 3.4:1.[8]

In the trade field, the 1992 program will require an end to some present disparities in the commercial policies of member-states, some of which predate the Treaty of Rome. These include: member-state VERs; member-state allocations of EC-wide MFA quotas and GSP duty-free quotas; some commodity arrangements under the Lome Convention; non-MFA restrictions on East European textile exporters; and controls on Asian electronics and car exporters. The sectors involved include cars, sugar, bananas, steel, electronics, shipbuilding and textiles. VERs have been widely used at both the Community and member-state levels. In May 1988, there were a total of 138 non-MFA VERs within the EC, 87 of which were EC-wide and 51 were imposed by individual member states. Just under half of all EC VERS were aimed at developing countries. France, Italy and the UK are the most prevalent users of VERs.

EC member-state deviations from the common commercial policy have always required approval from Brussels. Under a safeguard clause, Article 115 of the Treaty of Rome, member-states may seek EC permission to introduce protection against other member-states to prevent non-EC imports subject to a member-state restriction from being deflected from elsewhere in the Community. Some one to two hundred such Article 115 authorizations are approved or renewed by the Commission each year. The vast bulk of them are in textiles. A number of the Article 115 authorizations in manufacturing involve exports of Japanese firms from outside the Community. The output of

Japanese firms located within the Community may still be the subject of Article 115 authorizations if the output is deemed to be non-EC in origin.

Article 115-authorized restrictions are incompatible with a single market and will have to disappear under the 1992 program. It is not yet clear how this final harmonization of member-state protection is to be achieved. There are indications that the dismantling of Article 115 authorizations will involve some trade liberalization at the member-state level but this may be offset by EC-wide restrictions. It is still too soon to identify all the winners and losers among non-EC countries in the process, but there is unlikely to be much impact on the US. Japan, the NICs and some Third World and Eastern European countries have a greater stake in the outcome.

There is also a problem with trade between the two Germanies. A protocol to the Treaty of Rome recognized the special West German treatment of this trade as internal German trade, largely free of West German trade restrictions. However, other EC members will not be prepared to provide East German exports with unlimited access to the internal market through a West German window. The economic importance of this trade for West Germany, the world's biggest exporter, is rather minor, accounting for less than 2% of total West German exports. Its political importance is, however, enormous.

Japan, of course, has a major stake in the manner in which existing gaps in the common external commercial policy of the

Community are closed for 1992. US corporations have long-established manufacturing plants within the EC, are very aware of 1992 developments, and do not face uncertainties as to what constitutes good corporate citizenship in Europe. Currently, all member-states except Ireland and the UK employ quotas against Japan.[9] Five member-states, France, Italy, Portugal, Spain and the UK have imposed VERs on Japanese car exports. The British VER is industry-administered rather than governmental and restricts imports to 11% of estimated sales. The French limit is 3% of estimated domestic demand. The Italian VER dates from a Japanese effort to protect its domestic market from Italian imports through a 1956 bilateral reciprocal agreement. The present limit is 3,425 units.[10] Member-state electronics restrictions include a French limit on Japanese color television sets of 84,000 units annually.

In its negotiations with Japan, the Commission has undertaken to seek an end to member-state quotas. Italy's use of Article 115 to limit imports of Japanese cars was recently amended by the Commission, which established a 1989 quota of an additional 14,000 Japanese cars which Italy may be required to accept from EC sources. This is part of a general policy, applied since December 1987, of using delays in granting Article 115 authorizations as a way of enlarging the size of trade flows entering into free circulation.

There has been considerable jockeying as the Commission considers how the gaps in a common external policy toward cars may be closed to ensure an internal car market after 1992. The shape of any post-1992 EC-wide transitional restraint is still unclear. Some protectionist-leaning elements of the European car industry have suggested that an EC-wide VER of 10% on Japanese exports be coupled with a demand for a 5% EC share of the Japanese car market as the price for abandoning their current member-state protection. This is not Community policy. Meanwhile, Japanese producers have already begun to repeat their US strategy by establishing European plants. However, it should be noted that Japanese foreign direct investment in manufacturing within the EC has not grown as quickly as Japanese investment in North America. Between 1981 and 1988, Japanese foreign direct investment in manufacturing in North America rose from 19% to 41% of all Japanese foreign direct investment in manufacturing. In the same period, the share going to Europe only rose from 7% to 9%.[11]

Given that, some future trade friction involving US manufacturing exports to the EC may involve Japanese, rather than US, corporations. Honda plans to begin exporting cars from its Ohio plant to the EC in 1991, a development which would help the US reduce its global trade imbalance. While car producers in some member-states may wish to have Ohio Honda exports considered as Japanese rather than US exports on the grounds of insufficient US local content, there is little likelihood of such an outcome. The US content in the Honda plant is presently 62%, scheduled to rise to 75% by 1991.[12] Even now, a country-of-origin determination could not bypass the US-content and consider the 38% Japanese local content to constitute the last substantial operation. However, it is conceivable that in dismantling the present member-state auto VERs, the EC may be tempted to introduce EC-wide auto restraints as a way of coping with transitional difficulties in completing the internal market. They have two choices. To either go outside the GATT and seek to impose either EC-wide VERs on US, as well as Japanese, auto exports or to make use of GATT Article XIX which allows temporary protection in response to import damage to domestic industry.

Another example of the confusion between Japanese and American production can be found in electronics. In an action not directly related to its 1992 program, the Community has found the Japanese company, Ricoh, guilty of dumping photo-copiers produced in Japan and has considered imposing anti-dumping duties on Ricoh photo-copiers produced in California. In the Ricoh case, a product deemed sufficiently American in origin to qualify for the "Buy American" Act was deemed not sufficiently American in origin by the Commission to escape anti-dumping duties levied on products of Japanese origin.

These two examples suggest that, in eliminating existing disparities between member-state commercial policies, the 1992 program may provoke further instances in which the US Special Trade Representative is called upon to ensure EC market access for the output of Japanese-owned plants located in the US.

III The EC in a Wider Europe

The 1992 program is providing the impetus for a number of political changes which will impinge on EC-US relations. These developments are not all directly related to the completion of the internal market but are a byproduct of other changes produced by the 1985 Single European Act. In addition to providing the legal and institutional foundations for completion of the internal market, the Single Act also introduced a European Political Cooperation (EPC) process. The political cooperation process is separate from the economics of the 1992 program, but a mix of economics and politics is producing altered relationships with EFTA and with Eastern Europe. It may also produce a more complicated relationship with NATO, if EC's EPC process has to cope with more neutral members in any future enlarged Community.

Currently, all EC members except Ireland are members of NATO, while all European NATO members except Norway and Turkey are members of the EC. This may change if neutral members of EFTA, such as Austria or Sweden, join the EC after 1992.

The present stage of development of the EC coincides with realignments of forty-year old post-war political arrangements which have been frozen in place since Communist parties seized control of Eastern Europe. The 1992 program is being undertaken against a backdrop of political change in the Soviet Union and most of Eastern Europe. Closer cooperation is also occurring with the other great economic grouping in Western Europe, EFTA.

These changes present Western democracies with enormous opportunities. As a neighbor, the EC not only has trade and financing ties to Eastern Europe, it has long-established political and social links. Eastern Europe and the USSR take 7% of extra-EC exports and 2% of US exports.[13] These economic and non-economic links provide the EC's EPC process with some obvious advantages in assuming co-responsibility with the US in encouraging change in Eastern Europe. With a more assertive EC may come greater trans-Atlantic strain over appropriate responses to developments in the East.

The 1992 program has been a powerful stimulus for six EFTA members to reconsider their long-term relationships with the EC. Last month's informal joint ministerial meeting of EC and EFTA ministers laid the groundwork for further institution-building between these two organizations. While the Commission insists that internal development takes priority over enlargement, the EC-EFTA consultation machinery has become extensive. The EC-EFTA relationship now extends well beyond the free trade agreement signed in the 1970s. There is common documentation for customs clearance, EFTA participation in EC technology programs, joint determination of industrial standards and, after the recent informal EC-EFTA ministerial meeting, the possibility of EFTA observer status in some EC discussions. Although at least one EFTA country has raised objections, it is not inconceivable that we shall eventually see an EC-EFTA customs union.[14] Applications from some EFTA states for EC membership are also believed pending. Other strategically important trade and political permutations need no longer be considered inconceivable, including eventual membership of East European countries such as Hungary in either EFTA or the EC.

It was always apparent that the close fit which presently exists between Europe's defence and its economic integration would be weakened as the Community expanded. The neutrality issue looms large over EFTA. The neutral members of EFTA--Austria, Finland, Sweden, and Switzerland, -- and Ireland, the EC's single neutral, differ considerably in the circumstances of their neutrality. A Community with a larger number of neutrals would make it more difficult to achieve the adoption and implementation of common European positions as called for under the foreign policy cooperation provisions of Article 30 of the Single Act. But it need not make it impossible.

However, any dilution of EPC into a two-leg policy containing a NATO leg and a neutral leg would inevitably weaken US-EC political ties. But it might also produce some opportunities. While requiring, as now, the shelter afforded by the defence burden borne by NATO members, the members of such a neutral component could have a constructive part to play in future conversations between East and West Europeans.

The political strength of Western Europe ultimately lies in universal political values. A "forward defence" of these values by helping like-minded forces in Eastern Europe to obtain the political space to flourish may call for a sophisticated, diffuse approach and need not be over-threatening to Western

Europe's defence posture. Of course, it is also possible to envisage an internal Soviet backlash to current trends in the Soviet Union. The continued possibility of such an eventuality requires a muscular Europe, secure in its own ability and that of its allies, to provide an adequate defence.

The Community's identity and binding ideals have survived the growth in members from six to twelve. Within the twelve, as previously within the six, there is not a common vision of the role of the Community in the world. However, incoherence is avoided by the existence of sufficient common ground and a sufficient commitment to abide by Community decision-making machinery. The 1992 program provides a time for present members to further mold the long-term future shape of Europe.

Europe is being integrated, both economically and politically, in a process of stages. An approach of deliberate, concrete, attainable, economic objectives is serving to build political and social cohesion. The approach may produce some small, short-term economic costs for the US. It may generate some foreign policy disputes. But, there should be no doubt that a strong, united, democratic, and competitive Europe is in the long-term interests of the US.

ENDNOTES

1. World Bank, World Development Report 1987, p. 142. "Hard core" NTBs include import prohibitions, quotas, "voluntary" export restraints, variable levies, Multifibre Arrangement restrictions and non-automatic licensing. Measures excluded include health and safety restrictions, minimum pricing regulations, price surveillance and anti-dumping or countervailing duty investigations.

2. 1992 issues not subject to the qualified majority rule include fiscal matters, the free movement of people, and the rights and interests of employees. (Single European Act Article 18).

3. The December 31 1992 target for completion of the internal market is a target date for completion of actions at the Community level. Member-state implementation of some EC 1992 policies will take longer.

4. R. Cawley and M. Davenport, "Partial Equilibrium Calculations of the Impact of Internal market Barriers in the European Community", Commission of the European Communities, Research on the "Cost of Non-Europe", Basic Findings Volume 2.

5. A. Smith and A. Venables, "The Costs of Non-Europe: An Assessment based on a Formal Model of Imperfect Competition and Economies of Scale", Commission of the European Communities, Research on the "Cost of Non-Europe", Basic Findings Volume 2.

6. Council Directive 75/129 of February 17, 1975. Official Journal of the European Communities no. L 48/29.

7. Committee for the Study of Economic and Monetary Union, Report on Economic and Monetary Union in the European Community April 12, 1989, p. 8.

8. Commission of the European Communities, Third Periodic Report from the Commission on the Social and Economic Situation and Development of the Regions of the Community, Com(87) 230 final, Table 2.1-3.

9. Michiko Kunihiro, "The External Implications of 1992 I: A Japanese View", The World Today, February 1989, pp. 29-31.

10. Data from Margaret Kelly et al., Issues and Developments in International Trade Policy, IMF Occasional Paper No. 63 December 1988, p. 92.

11. Margaret Kelly *et al.*, *Issues and Developments in International Trade Policy*, IMF Occasional Paper No. 63, December 1988, p. 123.

12. Joann S. Lublin, "Japanese Auto Makers Jostling Past EC's Import Curbs", *Wall Street Journal*, March 17, 1989.

13. GATT, *International Trade 1987-88*, Tables AA10, AB8.

14. Any new enlargement will entitle the US and other EC trading partners to seek compensation for any resulting trade diversion under GATT Article XXIV.6.

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THE IMPACT OF 1992 ON THE EUROPEAN COMMUNITY'S EXTERNAL RELATIONS

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DRAFT. NOT FOR CITATION OR QUOTATION WITHOUT PERMISSION

This paper examines some of the wider political and economic dimensions of the external relations produced by the European Community's 1992 exercise. The paper is largely concerned with the EC's relations with the US and Japan. The EC's ties to these countries are two quite different economic and political relationships, with a vastly different mix between economic and security considerations. The economic relationship with the US is often bedeviled with the economics of the past -- agriculture -- while that with Japan is concerned with the future -- high technology. The political relationship with the US is intricately bound up with NATO and becomes particularly complicated when different assessments of an Eastern threat gain currency. The political relationship with Japan has been greatly restricted by Japan's cautious emergence on the world stage. Accordingly, the paper fixes on two devices to discuss the EC's evolving relations with the US and Japan -- NATO and 1992 in the case of the US-EC side of the triangle and Reciprocity and 1992 in the case of the EC-Japan side.

The Context

The 1985 White Paper was released into a world vastly different from that in which the European enterprises of the 1950s were undertaken.[1] After forty years, the post-World War II

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[1] It is worth pointing out that the present enthusiasm for completion of the internal market involves an effort to achieve an objective which the original six Rome Treaty signatories were due to achieve by 1970.

European arrangements are coming unglued as the East European political system breaks up. In the peripheral zone between the EC and the Nordic members of EFTA, Baltic nationalist movements are re-asserting themselves. At the other end of the continent, Balkan unrest threatens the Yugoslav state. EFTA countries are seeking further definition of Europe's economic space. A number of EC and EFTA members are examining what it means to be neutral.[2]

The changes in the two halves of Europe are part of larger global patterns of shifting economic power as the burden of running the economic international system is re-allocated. North-South resource transfers are becoming associated with the recycling of Japan's trade surpluses. Still to come are changes in voting strength in multilateral financial institutions such as the IMF and World Bank as Japan's voting strength is increased at the likely expense of France, Italy and the UK. In the US, despite the concern over Fortress Europe, it is clear that many US corporations plan to benefit substantially from 1992. Europe is being taken more seriously. Not too far behind may lie a re-allocation of defence burdens.

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[2] For a recent discussion of EC-EFTA relations, see Thomas Pedersen, The Wider Western Europe: EC Policy towards the EFTA Countries, Discussion Paper No. 10, Royal Institute of International Affairs, London, 1988.

Japan: Reciprocity and 1992

A single rubric may be adopted to discuss EC relations with Japan. It is reciprocity. The 1985 White Paper called for the consolidation of the commercial identity "so that our trading partners will not be given the benefit of a wider market without themselves making similar concessions".[3] The reciprocity issue has emerged in two related fields -- the GATT Uruguay Round and the 1992 program's requirement that gaps in the common external policy be closed by ending a number of member-state discriminatory trading practices or replacing them with EC-wide policies. In the first field, the EC's positions affect all trading partners and are not particularly directed at Japan. In the latter instance, Japan is clearly a country that EC officials have in mind when they state that the benefits of 1992 will not be given away.

Both the US and Japan appear uneasy at the EC's insistence on reciprocity in any new external arrangements made necessary by completion of the internal market. In some quarters, the principle of reciprocity has earned a protectionist tinge because of US efforts to see it used in new GATT-enabling domestic legislation such as the 1988 Omnibus Trade Act and because of the stress on reciprocity by Presidential candidate Richard Gephart. A fine distinction needs to be drawn between the long-established GATT-consistent use of reciprocity in multilateral negotiations over new trading rules and the GATT-inconsistent use of reciprocity in the application of established rules. There can be no reciprocity in the application of GATT rules without a breach of the fundamental principles of non-discrimination and MFN treatment found in Article I of the GATT.[4]

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[3] Com (85) 310 final, paragraph 19.

The 1992 exercise has coincided with the Uruguay Round which is due for completion in 1990, two years before the European 1992 deadline. For the rest of the world, these negotiations exercise some slight discipline on the shape of the external relations component of 1992. In the areas under negotiation, there is an opportunity for the rest of the trading system to influence 1992 outcomes. Already, the EC's negotiating position of reciprocity in trade concessions has shaped the manner in which a number of the 1992 directives have been drafted. Indeed, it would be rather unusual if, for example, the EC's Uruguay Round negotiating positions on either the Government Procurement Code or a new code to cover financial services were at variance with the proposed treatment of foreign entities found in the Commission's proposed draft directives for 1992 in these areas.

The EC stance toward Japan of seeking reciprocity in market access is complicated by the individual policies of some member-states. As mentioned earlier, this differentiation must disappear with 1992 if an internal market is to be created. In some instances, member states have sectoral arrangements with Japan which predate the establishment of the Community. Other arrangements are outside the GATT framework. Although not part of reciprocity, the Community's vigorous application of trade law to end GATT-illegal practices by individual Japanese corporations has had a major impact on trade flows and investment patterns. The EC's use of its anti-dumping statutes has been particularly important because of the manner in which the Community's country-of-origin regulations are evolving. Two sectors, cars and electronics, have figured prominently in EC or member-state actions against Japan.

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[4]. Obviously, the GATT has nothing to say about the use of reciprocity in protectionist agreements reached outside the GATT framework.

Grey-Area Measures

The past ten years have seen a proliferation of trade measures adopted by developed countries which are outside the GATT framework. These are invariably measures which, if subject to GATT scrutiny, would be declared illegal. The most pervasive have been so-called "voluntary" export restraint arrangements (VERs). Under VERs, the exporting country or trade-group agrees to limit exports to a particular country rather than trigger anti-dumping, escape clause or other trade-policy responses in the importing country.

As Table 1 shows, VERs have been widely used at both the Community and member-state levels. Member states relying on VERS must obtain Article 115 authorizations to make the VER effective. Article 115 of the Treaty of Rome is a safeguards clause which allows the Commission to grant permission to a member-state to introduce protection against other member-states to prevent imports from the non-EC country from being deflected from elsewhere in the Community. In May 1988 there were a total of 138 EC VERs, of which 87 were EC-wide and 51 were imposed by individual member states. Just under half of all EC VERS were aimed at developing countries. France, Italy and the UK are the most prevalent users of VERs. In addition to the restraints listed in Table 1, a very large number of restraints on textiles are negotiated as part of multilateral negotiations under the GATT-condoned Multifibre Arrangement (MFA). The textile VERs shown in Table 1 involve non-MFA members.

Table 1
EC-wide and Member-State VERs excluding MFA, May 1988

	EC-wide	Member Imposed	By	Target Countries		
				Developed	LDC	East Europe
Agriculture, Food	36	4	France, Ireland, Italy	13	16	11
Textiles, Clothing	18	3	Germany, UK	0	19	2
Footwear	1	10	France Italy UK	0	8	3
Electronic Goods	5	11	France Italy UK	7	9	0
Machine Tools	2	1	UK	3	0	0
Cars, Transport	2	11	France, Italy, UK, Spain, Port.	13	0	0
Steel	14	1	UK	7	3	5
Other	10	10	Benelux, Denmark, France, UK	7	10	2
TOTAL	87	51		50	65	23

Source: GATT, Review of Developments in the Trading System, 1988.

Japan's exports have figured in several EC-wide VERs. VERs imposed by member-states will be discussed later. Japanese car exports to the Community have been subject to EC-wide surveillance since 1981. While the 1983 VER on cars did not contain a quantitative target and expired in 1986, Japanese statements in later years on export intentions included a 1988 target of 1.21 million units. Japan has also been the target of EC VERs in electronics. In a related practice, Japan voluntarily monitors its exports to the EC of a number of electronics products. These include color TV sets and tubes, numerically controlled lathes and machining equipment. An EC-wide VER on VCRs was introduced in 1983. It was renewed after expiration in 1986 and current Japanese VCR exports to the Community are set at 1.7 million units.[5]

GATT-Consistent Measures

In both the US and the EC, local-content has been fastened upon as one of the devices recommended by adherents of protectionist versions of reciprocity, particularly in relations with Japan. Local-content criteria are currently used to establish the country-of-origin of products so that the appropriate customs treatment may be applied. Country of origin determinations have a large part to play in determining who is to benefit from completion of the internal market, as a number of Japanese corporations have already found. These determinations are being used to decide what is to be considered a European product and what is not, what, for example, is to be subject to a common external commercial policy after 1992 and what is to be subject to the internal competition policy of the Community, what will qualify for 1992 directives on European public procurement and what will be treated under the GATT Code of Conduct on public procurement. The standards to be used in making these determinations are drafted by the Commission for consideration by the Committee of Origin and the Council of Ministers. Under the Rome Treaty's Article 113, member-states use qualified voting in both the committee and the council.

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[5]. Kelly et al., op. cit., p. 83.

There is no common GATT standard on how to determine a product's country-of-origin. In practice, each GATT signatory has some discretion in deciding whether particular imports fit into country-of-origin categories which would be subject to non-MFN treatment. This treatment may include preferential treatment, e.g. GSP, penal treatment, e.g. anti-dumping or countervailing duties, VERs or quotas etc. Completion of the internal market produces a new category of GATT-consistent preferential treatment -- that to be afforded to products deemed to be sufficiently "European". Products deemed "European" cannot be subject to Article 115 authorizations in the present preliminary stage of completing the internal market, or to any likely replacement for Article 115 after 1992 when gaps in the common commercial policy must be eliminated.

The 1968 regulation governing EC-wide country-of-origin determinations identifies the country of origin of a product as the country in which the last substantial or economically-justified operation took place.[6] Through time, specific regulations have examined the production technology for particular products such as tape recorders, television sets, ball-bearings etc. and have provided product-specific interpretations of the 1968 regulation. These interpretations have included both quantitative and non-quantitative local-content criteria of the "substantial" or "economically justified" tests to be made in determining country of origin.

Japan has been on the receiving end of recent elaborations of both EC and member-state country-of-origin practices. Commodities involved have included integrated circuits, photocopiers and electronic typewriters. In separate instances, these EC-wide determinations are being used to decide, inter alia, whether the output of Japanese-owned plants was EC in origin, US, Taiwanese or Japanese, and to guide decisions in imposing anti-dumping duties and subjecting imports to QRs.

A non-quantitative local-content criterion for integrated circuits was introduced in the February 1989 Commission draft regulation which requires that the mask-diffusion process, in which circuits are etched onto silicon wafers, take place within the Community in order for chips to qualify for EC origin. At present, there are no EC-wide trade barriers against integrated circuits. However, adoption of the regulation coincided with EC-Japan discussions on minimum prices for chips exported to the EC and gave Japanese manufacturers an indication of what would be required in order to avoid possible anti-dumping or escape clause actions in the future.

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[6]. Article 5, EEC Regulation No. 802/68.

The present Commission draft regulation on determining the country of origin of photocopiers affects not only Japan but also the US. The country of origin determination in the case of integrated circuits specified that a particular part of the manufacturing process, mask diffusion, determined country of origin. An exclusionary strategy was adopted in the case of photocopiers, where the Commission has listed activities which do not meet the "last substantial or economically justified " test needed to confer country of origin. The Commission has also identified a number of activities, such as manufacture of circuit boards, motors, transformers and generators and the grinding of lenses which would meet the "substantial" criterion. The Japanese corporation affected by this case is Ricoh, already found guilty of dumping. Its exports from a Californian plant would have been subject to the same 20% duty facing its exports from Japan if the Californian output were deemed to be Japanese rather than US in origin.

A quantitative target of a minimum 45% local content was adopted by the Commission for tape-recorders. Japanese corporations presently assembling tape-recorders within the EC will need to meet this minimum in order to have their products qualify as "European" for purposes of the internal market.

A significant EC-wide 40% local or third-country content criterion was introduced in 1987 to EC anti-dumping regulations to deal with "screw-driver plants". It is a French, not EC, position that 80% EC local-content should be necessary in order for a product to be deemed of EC origin, as the dispute over the Sunderland Nissan Bluebird plant demonstrated. The 40% "screwdriver plant" provision was aimed at assembly plants established by firms found guilty of dumping or by firms closely allied or controlled by dumping violators. Japanese exports of electronic typewriters and electronic scales had become subject to anti-dumping duties in 1985. Japanese exporters of photocopiers were also found to have dumped on the EC market. Violators sought to avoid paying dumping duties by importing the components of the finished product and assembling them within the EC. To avoid having to undertake anti-dumping investigations against every imported component in products previously deemed to have been dumped, the Community decided that the output of screw-driver plants would be subject to anti-dumping duties. Duties are avoided if less than 60% of the value-added originated in the country of origin of the dumped product. Today, the use of "screwdriver plants" within the Community has been largely ended. In the meanwhile, the Court of Justice is deciding the status of third-country screwdriver plants in the anti-dumping case against Brother involving typewriters assembled in Taiwan from components produced in Japan.

Gaps in the Common Commercial Policy

Japan has a major stake in the manner in which existing gaps in the common external commercial policy of the Community are closed for 1992. These gaps arise because of QRs or VERs employed by individual member-states, some of which predate the Treaty of Rome. As mentioned earlier, Article 115 of the Treaty of Rome is used to ensure no trade deflection from other member-states. Indeed, an indicator of completion of the internal market will be the extent to which reliance on Article 115 authorizations ends. Continued use of Article 115 will mean that the internal market has not been completed. The 113 Committee is examining how harmonization or elimination of disparate member-state trade measures should occur. As the UK-France dispute over the Sunderland plant showed, removal of the present gaps in the common external policy produces considerable strains among members. Sectors where there are currently gaps in a common external policy include cars, steel, electronics, shipbuilding and textiles. There is also a gap due to the trade between the two Germanies. This will be included in our discussion on EC-US relations.

At end-1987, a total of over 1600 Article 115 authorizations were in place, the vast bulk (1176) of them in textiles, with 423 further authorizations aimed at manufacturing products.[7] A number of these involve exports of Japanese firms from outside the Community and, as we have seen above, the output of Japanese firms located within the Community may still be the subject of Article 115 authorizations if the output is deemed to be non-EC in origin.

The EC car industry employs 1.7 million workers directly, 8% of EC manufacturing employment. Although registering a 21 billion ECU trade surplus in 1986, the industry is under heavy pressure from Japanese competition. The depreciation of the dollar has also severely reduced exports to the US in the past couple of years. Five member-states, France, Italy, Portugal, Spain and the UK have imposed VERs on Japanese car exports. The British and French VERs are industry-to-industry agreements and are not recognized by the Commission as the actions of member governments. As a result, these member-states are unable to rely on requests for Article 115 authorizations and must use other devices such as restrictive car registration procedures to prevent trade deflection. The British VER restricts imports to 11% of estimated sales while the French limit is 3% of estimated domestic demand. The Italian VER dates from a Japanese effort to protect its domestic market from Italian imports through a 1956 bilateral reciprocal agreement. The present limit is 3,425 units.[8] Member-state electronics restrictions include a French limit on Japanese color television sets of 84,000 units annually. The establishment of Poitiers as the clearing house for all VCR imports into France was a particularly egregious instance of member-state protection.

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[7] Data from Andre Sapir, "Does 1992 Come Before of After 1990?", mimeo November 1988.

In its negotiations with Japan, the Commission has undertaken to seek an end to QRs which ten member-states maintain against Japan. The two exceptions are Ireland and the UK.[9] In February 1989, Italy announced a program to phase out most QRs on Japanese products by the time of completion of the internal market. Currently, Italian QRs on Japanese exports include toys, canned fish, silk and cable. Notable exceptions from the Italian announcement are cars, sewing machines and motor cycles under 380 cc's. Italian reciprocity seeks greater access to the Japanese market or the establishment of Japanese plants in Italy as the price for elimination of these QRs. Italy's ability to avoid trade deflection of Japanese cars exported to other member-states under Article 115 was recently amended by the Commission which established a 1989 quota of an additional 14,000 Japanese cars which Italy may be required to accept from EC sources. These are in addition to imports under its present reciprocal agreement with Japan.

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[8]. Data from Margaret Kelly _et al_., _Issues and Developments in International Trade Policy_, IMF Occasional Paper No. 63 December 1988, p. 92.

[9]. Michiko Kunihiro, "The External Implications of 1992 I: A Japanese View", _The World Today_, February 1989, pp. 29-31.

There has been considerable jockeying as the Commission considers how the gaps in a common external policy toward cars may be closed to ensure an internal car market after 1992. The shape of any post-1992 EC-wide transitional restraint is still unclear. Meanwhile, Japanese producers have already begun to repeat their US strategy by establishing European plants. Some protectionist industry sources have suggested that an EC-wide VER of 10% on Japanese exports be coupled with a 5% EC share of the Japanese car market as the price for abandoning their current member-state protection. In negotiating greater access to the Japanese market, the Community has been hampered by the absence of EC-wide technical standards. These will be necessary as part of 1992 and will make it easier to establish equivalence between EC and Japanese standards for purposes of exports to Japan.

As EC trade policy is more clearly defined and enforced in the years prior to 1992, Japanese investment in the EC has grown. However, it should be noted that Japanese foreign direct investment in manufacturing within the EC has not grown as quickly as Japanese investment in North America. Between 1981 and 1988, Japanese foreign direct investment in manufacturing in North America rose from 19% to 41% of all Japanese foreign direct investment in manufacturing. In the same period, the share going to Europe only rose from 7% to 9%.[10]

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[10] Margaret Kelly et al., Issues and Developments in International Trade Policy, IMF Occasional Paper No. 63, December 1988, p. 123.

Tables 2 and 3 show recent patterns in Japanese direct private investment in the EC. The car industry represents a considerable share of this investment, much of it financed by European taxpayers. Prime Minister Thatcher's package of investment incentives to Nissan to open the Sunderland plant was reported to approximate 40% of the investment costs.[11] Already, there have been signals of Commission dissatisfaction with the prospect of member-states entering a bidding war for Japanese plants. Of the $3.3 billion of Japanese direct investment in European manufacturing in the fiscal year ended March 31 1988, over $700 million was in the car industry.[12] Apart from the Nissan Sunderland plant and the Honda joint production with Rover, Mazda is exploring setting up a plant in Spain, Fuji Heavy Industry had intended opening a Subaru plant in France but, because of French opposition, is considering other EC sites, and Toyota has yet to announce the winner in its site selection plans.

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[11] David Usborne, "Trade Row Likely over Car Imports", The Independent, November 11, 1988.

[12] Idem.

Table 2
The Stock of Japanese Direct Investment in the EC
(Fiscal Years ending on March 31)

	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87
$ Billions	3.9	4.5	5.3	6.2	7.7	10.0	13.4
% change	10.7	10	10	10.1	10.8	12	12.6

Source: Commission of the European Communities, Relations Between the Community and Japan: Recent Developments, Com (88) final -II, March 15 1988.

Table 3
The Stock of Japanese Direct Investment in the EC
($ Millions, March 31 1987)

	B	DK	D	GR	E	F	IRL	I	L	NL	P	UK	E12
Manufacturing	238	2	277	94	461	310	160	100	4	198	22	488	2357
Food	-	-	5	-	3	47	-	8	-	8	-	18	84
Textiles	0	-	-	-	19	47	104	9	-	2	8	9	190
Lumber, Pulp	-	-	-	-	0	0	-	-	-	-	-	-	0
Chemicals	36	-	21	16	44	10	0	12	-	68	1	6	222
Metals	25	-	0	76	24	56	6	3	-	38	-	29	257
Machinery	15	2	69	-	6	40	1	7	-	21	1	91	261
Electrical	10	-	128	-	57	52	28	6	4	30	1	177	493
Transport	32	-	8	0	302	6	-	42	-	1	6	97	494
Other	121	0	45	2	6	44	21	13	-	29	5	61	347
Non-Manf.	467	15	1025	1	62	536	170	70	2305	2133	5	3586	10375
Agriculture	-	-	-	-	0	-	0	-	-	-	-	0	0
Fisheries	-	-	-	-	1	-	1	0	-	-	-	0	2
Mining	-	-	-	-	-	55	17	-	-	-	-	818	890
Construction	0	-	18	-	0	-	-	-	-	17	-	21	56
Commerce	221	14	861	1	59	343	5	61	2	614	2	506	2689
Banks, Insurance	204	-	74	-	2	26	-	0	2180	1417	3	1388	5294
Services	20	1	11	-	-	85	146	4	1	19	-	51	338
Transportation	9	-	2	-	-	0	-	-	-	6	-	2	19
Real Estate	2	-	1	-	0	10	-	-	20	11	-	91	135
Others	11	-	58	-	-	16	1	5	102	49	0	708	950
Branches	84	0	245	-	75	103	2	32	-	4	0	42	587
Real Estate	0	0	5	-	1	15	0	1	-	0	0	18	35
TOTAL	789	17	1552	95	599	972	332	203	2309	2336	26	4125	13355

Source: Commission of the European Communities, Relations Between the Community and Japan, March 15, 1988, Com (88) 136 final.

The US: NATO and 1992

Like Japan, the US has economic concerns over 1992 as last year's bruising battle over the draft banking directive proved. However, unlike Japan, economic concerns are secondary to political concerns. Some coming instances of trade friction involving US manufacturing exports to the EC may involve Japanese rather than US corporations. These include Honda plans to begin exporting cars from its Ohio plant to the EC in 1991. Car producers in some member-states will wish to have Ohio Honda exports considered as Japanese rather than US exports on the grounds of insufficient US local content. The US content in the Honda plant is presently 62%, scheduled to rise to 75% in 1991.[13]

A confrontation over local content in US car exports would place President Bush in the same position *vis a vis* the Community as Prime Minister Thatcher was *vis a vis* France in the Bluebird case. It evokes an interesting scenario of US STR and the UAW allied with Nissan and MITI against the Commission. In electronics, the Community has considered imposing anti-dumping duties on Ricoh photo-copiers produced in California. In the Ricoh case, a product deemed sufficiently US in origin to qualify for the Buy American Act was deemed not sufficiently US in origin by the Commission to escape anti-dumping duties levied on products of Japanese origin.

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[13] Joann S. Lublin, "Japanese Auto Makers Jostling Past EC's Import Curbs", *Wall Street Journal*, March 17, 1989.

The presence of Japanese corporations in EC-US trade disputes is not so much an indication of the relative decline of the manufacturing base of the US as a reflection of the early stage of globalization of production still to be found in many Japanese corporations. US MNCs have long-established manufacturing plants within the EC, are very aware of 1992 developments, and do not face the same uncertainties as to what constitutes good corporate citizenship in Europe.

EC-US relations are better discussed in a wider strategic framework than is required for Japan. The 1992 program is providing the impetus for a number of political changes which, in turn, will impimge on EC-US relations. These changes include the manner in which 1992 influences EC ties with EFTA and with Eastern Europe, with NATO, particularly as EPC copes with neutrality. Currently, all EC members except Ireland are members of NATO while all European NATO members except Norway and Turkey are members of the EC. Seven EC members are also members of the WEU.

Neutrality

It was always apparent that the close fit which presently exists between Europe's defence and its economic integration would be weakened as the Community expanded. The 1992 program has been a powerful stimulus for EFTA members to reconsider the type of long-term relationship sought with the EC. While the Commission insists that internal development takes priority over enlargement, the EC-EFTA consultation machinery has become extensive. It has yielded EC-EFTA wide adoption of the Single Administrative Document, EFTA participation in EC technology programs, joint determination of industrial standards and, after last week's informal EC-EFTA ministerial meeting, the possibility of EFTA observer status in some EC discussions. The 1992 program has shaped the agenda in EC-EFTA and is now the impetus for EFTA to develop the new institutional machinery called for by Mr. Delors in his January 17, 1989 speech to the European Parliament.

The neutrality looms large over EFTA. Even a customs union comprising the larger European economic space inhabited by the EC and all of EFTA would require a coordinated external trade policy for an eighteen-country grouping of diverse defence postures, twelve of which were attempting to develop a common political policy. In his January 17, 1989 speech, President Delors reminded the European Parliament that signatories to the Single Act had affirmed their willingness to create a European Union and stated "that means one for twelve and twelve for one". There are those who would leave little room for neutrals in a Europe of twelve or more musketeers. Already, calls for adding an independent European defence and foreign policy to the EEC may be heard. Last year, ex-Prime Minister Edward Heath warned against further enlargement of the Community through membership of neutrals on the grounds that it would dilute any effort at developing an independent European defence policy.[14]

The neutral members of EFTA, Austria, Finland, Sweden and Switzerland differ considerably in the circumstances of their neutrality. Austria, a transit state between EC member-states Germany and Italy, defined its neutrality in its Neutrality Law as the price of ending Soviet occupation. Its 1955 State Treaty with the four powers, France, UK, US and USSR, ruled out economic and political integration into a greater German state. Irish neutrality was also self-defined in the presence of an occupying power, but from the relative isolation of the edges of Europe. Strategic considerations of the kind which are foremost in the instances of buffer-state EFTA neutrals such as Finland and Austria were absent. Irish neutrality has, in part, been determined by relations with the neighbouring UK. It was politically inconceivable in 1949 that Ireland would join an alliance in which it would be pledged to come to the defence of the UK, a country occupying part of its national territory. Border disputes have not loomed so large for other EC member states such as Spain and the UK, over Gibraltar, or for Greece and EC-applicant Turkey. In the Irish case, a resolution of the political problem of Northern Ireland may be a necessary precondition of Irish participation in an alliance in which it would be pledged to aid in the defence of the UK.

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[14] Edward Heath, "European Unity over the next Ten Years: From Community to Union", International Affairs, Volume 64 No. 2, Spring 1988, pp. 199-207.

The Single Act's provisions for European Political Cooperation (EPC) under Article 30 explicitly recognize the limits of cooperation in the presence of a neutral. Ireland's flexible, if not Jesuitical, approach to neutrality had permitted it to view accession to the Treaty of Rome as consistent with neutrality. Its accession was also accompanied by political statements prior to June 1972 from senior members of the two biggest political parties that Irish neutrality could be reconsidered at a later time. The Irish government's view on EPC and neutrality was laid out at the time of the referendum on the Single Act. It stated that coordination of positions on the political and economic aspects of security does not include the military aspects of security or procurement for military purposes and does not infringe on a country's status of military neutrality.[15] The government had also pointed to the participation of the EFTA neutrals in EC advanced technology programs which foster economic security. There will be considerable pressure on Austria, should it apply for EC membership, to renounce its neutrality. As the Irish case shows, it is possible to combine adhesion to the Single Act with neutrality, despite the alternative interpretations which others might wish to give to EPC.

It will be some time before the EC's single neutral member is augmented. The Commission's Directorate-General for External relations, DG I, is presently handling Uruguay Round negotiations as well as issues emerging from the 1992 Directives. Even if the Community was not preoccupied with completing its internal market, DG I's limited resources would suggest that another accession negotiation may not occur until after the Uruguay Round has been completed. By the time that the number of neutrals in the EC increases, Eastern Europe will have experienced further political changes.

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[15] Ireland, The Stationery Office, The Single Act: A Government Information Booklet, May 1987 p. 8.

For the longer term, a Community with a larger number of neutrals may make it more difficult to achieve the adoption and implementation of common European positions as called for under the foreign policy cooperation provisions of Article 30 of the Single Act. But it need not make it impossible. It is possible to envision, at a time of momentous developments in Eastern Europe, the eventual appearance of some common elements comprising a European "neutrality policy" among the various shades of neutrals in any EC-EFTA union. This could form a second leg of EPC. While requiring, as now, the shelter afforded by the defence burden borne by NATO members, the members of such a neutral component could have a constructive part to play in the next stage of conversations between East and West Europeans. The political strength of Western Europe ultimately lies in universal political values. A "forward defence" of these values by helping like-minded forces in Eastern Europe to obtain the political space to flourish may call for a sophisticated, diffuse approach and need not be over-threatening to Western Europe's defence posture.

Enlargements to include additional neutrals need not threaten the cohesion and political character of an institution still a'growing. The identity and binding ideals of the Community have survived the jump in members from six to twelve. Within the twelve, as previously within the six, there is not a common vision of the rọle of the Community in the world. However, there has been sufficient common ground and sufficient commitment to abide by Community decision-making machinery so as to preclude any general sense of incoherence. The 1992 program provides a time for present members to use existing voting arrangements to settle a little further the long-term future shape of Europe. The Single Act's widening of the use of majority voting to most 1992-related areas made it desirable to have the character of the Community more firmly established by the present set of members before further enlargements dilute voting power.

Of course, it is also possible to envisage a backlash to current trends in the Soviet Union culminating in the installation of a military government. The continued possibility of such an eventuality requires a muscular Europe, secure in its own ability and that of its allies to provide an adequate defence. For the moment, even as political incoherence grows in the East, the NATO burden-sharing debate is being conducted with a new vehemence. For many Germans, low-flying F-16s in the late

1980s are no longer associated with Berlin-bound DC3s of 1948-49. A re-evaluation is also occurring in the US, reminiscent of the earlier exercises of Senator Mansfield in the 1960s and early 1970s.

By the Pentagon's own estimate, about 58% of its budget is devoted to NATO. The annual dollar cost is about $150 billion, roughly equivalent to the 1988 US budget deficit.[16] About one third of the $150 billion is spent on manpower in Europe. Another third is spent on manpower based in the US but assigned to defending Europe.[17] For Calleo, "once the pretension of running European defence is abandoned, America's standing commitment to Europe's territorial defense could be reduced from its present ten to only five divisions. All five could be deployed in Europe; or perhaps one or two could be based in the United States and earmarked for Europe. In budgetary terms, disbanding five US divisions could eventually save tens of billions of dollars - some put the estimate around $50 billion a year."[18]

The recent US decision to renegotiate the terms of the US-Japan FSX agreement in an effort to limit technology transfer to Japan has important implications for EC high technology industries and for US-European relations within NATO. Defence procurement is excluded from the GATT government procurement code. The exclusion is typical of the separate tracking of security and economic issues. Within the US, the twin budget and trade deficits have caused some dilution of this tracking when US trade deficits are ascribed to inequitable defence burden-sharing arrangements between the US and its allies.

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[16]. Bobby Inman, " Balancing the Transition" in New Perspectives Quarterly, Volume 5 No. 1 Spring 1988, p. 25.

[17]. David Calleo,"The end of hegemony on the cheap" in New Perspectives Quarterly, Volume 5 No. 1 Spring 1988, p. 33.

[18]. Calleo, op. cit., p. 34.

The FSX case is but one of a number of instances in which the separation between economics and security has been breached in US-Japan relations. The US Department of Commerce established a precedent in the FSX case by becoming a player in the Department of Defence's co-production negotiations. Its tougher trade negotiating stance is likely to make future US-European co-production agreements a little more difficult to achieve. While the antipathy to Japan which emerged in the recent FSX dispute had its origins in US fears of losing the technological race to Japan, Commerce Department participation in future US-European co-production discussions may also erode the separation between security and trade issues in US-European relations.

1992, Orphans and the European Economic Space

While the US watches nervously as 1992 produces closer working relations with neutrals, it also has an interest in how the 1992 program helps to solve Europe's dirty little secret--Turkey,-- one of President Delors' "orphans of Europe". Having applied for full membership in April 1987, Turkey, with a mere association agreement and no large stakes in influencing the 1992 process, has been shut out as the Community describes its EFTA ties as a "special relationship". The US would appear to have a large interest in not seeing Turkey rebuffed. Its importance to NATO is considerable. Apart from its own merits, a number of events would appear to conspire against the success of the Turkish application. These include the Rushdie affair, the Pan Am bombing and the revival of religious fervor in Turkey. All are events which increase European unease with Islamic culture and the Middle East. The right-wing anti-immigrant backlash in recent French and German elections also will not help.

Turkey has been left with the prospect of no initial Commission opinion on its membership application until the end of 1989 and no Council or Parliament deliberations until even later. Parliamentary opposition to Turkish membership on grounds of continued human rights violations is strong and under the Single Act, Parliament's influence on applications has been strengthened. The European Trade Union Confederation is also opposed, citing the denial of trade union rights. If denied, Turkey may see another EFTA member leapfrog over it into full membership, perhaps under cover of the Single Act's Article 23's call for the strengthening of economic and social cohesion.

1992 and Cross-European Space

The US has a clear strategic interest in the manner in which EC-East European relations develop. A network of trading relationships are being established following resolution of the long-standing stalemate as to how EEC-Comecon relations were to be conducted. The EC's insistence that the substantial differences in character between the EEC and Comecon required bilateral trade agreements with each of the members of Comecon rather than an overall agreement between the EC and Comecon has prevailed. The EC has been recognized by all of Eastern Europe except Rumania and the first bilateral agreements have been negotiated with Hungary and Czechoslovakia. Agreements with Poland and Bulgaria are to follow. Others are in preparation.

The existing bilateral relationships between member-states and East European countries will require amendment to ensure conformity with a common commercial policy after completion of the internal market. Among the gaps in a common commercial policy which will require closing are member-state restrictions on textiles and steel. The relationship between the two Germanies presents some difficulties for other member-states. A protocol to the Treaty of Rome recognized the special West German treatment of this trade as internal German trade which is largely free of West German trade restrictions. However, other EC members will not be prepared to provide East German exports with unlimited access to the internal market through a West German window. Article 3 of the protocol leaves member-states with the power to "take appropriate measures to prevent any difficulties arising for it" from this trade.[19] The economic importance of this trade for West Germany, the world's biggest exporter, is rather minor, accounting for under 2% of total West German exports. Its political importance is obviously enormous. At some point it is possible to envisage trade relations with East Europe progressing to the point where associate membership with the Community might be considered. In addition to further political changes in the East, withdrawal of the Red Army might be a precondition of associated status.

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[19] Treaties Establishing the European Communities, abridged edition 1987, p. 365.

Conclusion

What does everybody mean by Fortress Europe? The Commission's own estimates are that the 1992 program would worsen the trade balances of the EC's trading partners by about 1% of EC GDP. While Europeans may be able to show that all of this policy-induced improvement is achieved without the slightest contravention of the GATT, others, in the US and Japan, are still likely to concentrate on whether the Community has become more or less open, more or less self-reliant, rather than more or less rule-breaking.

Much of the economic gains to accompany 1992 are attributable to economies of scale made possible by a single market. Not all these gains may be realized and, in particular, may not be realized by non-EC firms. Recent EC country-of-origin rulings suggest that global marketing plans of US and Japanese

MNCs which concentrate economies of scale in production facilities located outside the EC will be threatened. The threat is limited by the GATT but may be made good if producers are found guilty of unfair trade practices such as dumping or, under Article XIX, are subjected to temporary restrictions through the safeguards clause.

The pre-1992 direction of EC trade policy may, as Ricoh argued in its photocopier anti-dumping case, reduce the amount of intra-industry trade occurring between the EC and the US and Japan, particularly when Japanese corporations are involved. Global strategies in which the production of some product lines is concentrated in the EC to serve both the EC and world market, while the EC market for other product lines is served from plants outside the EC will be threatened. If the end-result is shorter production runs and a greater than optimal number of production facilities, some economies of scale will have escaped both EC and world consumers.

For the US, the adverse economic impact of 1992 may be small. However, 1992 has also pushed the Community a little further along the road to EPC and further enlargements. These changes, occurring simultaneously with the unravelling of political structures in Eastern Europe, are likely to test the ingenuity and flexibility of those in charge of US foreign policy.

Representative HAMILTON. Well thank you very much, gentlemen. We'll proceed with questions.

I guess the great question American politicians wrestle with all the time is what's in it for me? We get that question in one form or another every hour. So what's in it for us, and now let's take a look at it from the point of view of the American consumer.

You've spoken with regard to the American business community, and we'll get to those questions in a moment, but how do you explain to the ordinary American consumer out here what 1992 is all about and what's in it for him or her?

Mr. HORLICK. The best example I think in the way of explaining this is to look at the United States. The United States really was the first common market, and we had the wisdom or luck to do it in 1789. What we hope that integration in Europe means is two things.

First, it will mean growth in Europe, something that Mr. O'Cleireacain dealt with. Growth in Europe means more U.S. exports and more jobs in the United States and so on, and I think consumers here recognize that.

Second, and I don't want to sound naive about it, but it is a fact of life that if you have more efficient production in Europe you're going to have more competitive production and lower prices for manufactured goods in the United States because we will have to compete with them. Competition is what makes life better for consumers here, and I think consumers here recognize the benefits of competition.

Representative HAMILTON. Do all of you agree with that?

Mr. O'CLEIREACAIN. Yes, I think so.

Mr. COONEY. Yes, Mr. Chairman.

Representative HAMILTON. So 1992 then is going to be very beneficial, in your view, for the American consumer because he's going to pay less and he's going to have more jobs, right?

Mr. COONEY. Yes.

Mr. O'CLEIREACAIN. I would not overestimate the benefits that would come from lower prices. I think the general thrust is good, but the reduction in prices likely to come may not be that enormous.

Representative HAMILTON. Now what about this trade deficit we have in this country? How is Europe 1992 going to affect our trade deficit? They are a very big customer and you've emphasized that. They receive what, a quarter of our exports?

Mr. COONEY. Roughly, yes.

Representative HAMILTON. And we've had a nice swing there recently, haven't we?

Mr. COONEY. That's right.

Representative HAMILTON. As 1992 goes into effect, is that going to help us with our trade deficit problem in this country?

Mr. COONEY. Well, I would like to answer that, if I can, from a personal perspective because I have a little story to tell on myself about that. I wrote a report for NAM in 1986 on "Can We Eliminate the Trade Deficit by 1990," and in looking over Europe at that time there was so much pessimism about Eurosclerosis, high unemployment rates and low growth, that I predicted that the best we could do by 1990 was perhaps get that trade deficit down to where it is today, a $5 to $10 billion U.S. deficit, but that we could not hope for it to improve much beyond that because of tremendous European restructuring and growing problems. I think that the European Community's 1992 program has already, in connection with some other developments in Europe, led to much more encouraging growth prospects.

I think year by year if you look back over the forecast of the OECD and the European Commission itself you will find that people have underestimated growth rates in Europe. We don't try to dictate policy to Europe, but we think that the 1992 program is one way we can see growth at an EC-wide level of 3 or 3½ percent being sustained for a longer period of time.

I think that creates a possibility that we can move from roughly a balanced or small deficit situation with Europe that we're in today to a somewhat stronger surplus position with Europe, and Europe won't mind it because their own domestic growth is relatively strong. We won't be looked at as an enemy, but rather as a cooperative trade partner.

Representative HAMILTON. Do the rest of you agree with that?

Mr. O'CLEIREACAIN. Mr. Chairman, I would add a couple of observations to it. I think that in doing something about the U.S. trade deficit one should not look to the 1992 program as a major contributor to that deficit. The problems are much more long term and much more fundamental. They have to do with budget deficits and the absence of saving in the United States.

Mr. HORLICK. Just one historical note. We historically ran a significant surplus with Europe right up through the 1970's until about 1980 or 1981. We only went into deficit with Western Europe I think in 1982 or 1983.

Representative HAMILTON. You would see 1992 as a means of the United States increasing its exports?

Mr. COONEY. Yes, I would.

Mr. HORLICK. Yes.

Representative HAMILTON. All of you think that we would be exporting more to Europe; is that right?

Mr. O'CLEIREACAIN. Particularly smaller firms.

Representative HAMILTON. Will U.S. firms in Europe have an advantage over firms which export from the United States, and why do you say smaller firms?

Mr. O'CLEIREACAIN. I think that smaller firms in the United States that are nontraditional exporters face major opportunities. I think the large corporations are well established in Western Europe, and they are to some extent more European than many existing European firms. They have treated Western Europe to some extent as a European-wide market already.

Representative HAMILTON. So you see the major benefits coming to U.S. firms that are not in Europe?

Mr. O'CLEIREACAIN. I think, Mr. Chairman, that will be part of the gains. I'm not sure whether it's going to be major, but it's going to be a new source of gains. There are also going to be exports generated by the activity of U.S. subsidiaries already operating in Western Europe that are going to take inputs from the United States.

Representative **Hamilton**. Usually I've heard it that the U.S. firms that are in Europe are going to benefit more than the U.S. firms not in Europe but exporting to Europe. Would you agree with that or not?

Mr. **O'Cleireacain**. I think I probably would.

Representative **Hamilton**. Would most of you agree with it or all of you?

Mr. **Cooney**. Well, this is a very complicated relationship. I think the fact is that we should see a strong growth of U.S. investment in Europe. We have already seen that the last few years, but much of that, incidentally, is exchange rate related and is not a real growth of investment, but a nominal growth of investment due to the currency exchange translation effect as they call it on corporate reports.

Historically, U.S. exports have been strongest where U.S. investment has increased rapidly, and that's why we say we think both groups will benefit, both companies which primarily service the market through investment and those which service it through exports.

I must also quote our chairman, Mr. Heckert of Du Pont, who at a press conference when he introduced this report that you've already mentioned stated that for being in the market as a major player over a long period of time a company probably has to consider an investment strategy, but that, as I want to emphasize in my statement, does not mean that exports are displaced.

It just means that sales are greater and you're going to service some of those sales, or perhaps the majority of them over a long period of time through production facilities in Europe, but you still will increase demand for exports from the United States on a net basis through capital equipment imports and through imports of components and other export items related to investment.

I just want to make one final point. There are certain aspects of the EC-92 program which clearly make it advantageous to have some type of presence in Europe. Mr. Horlick mentioned the standards issue.

The standards issue is very difficult to follow from the United States with the best will in the world from our Department of Commerce and from the American National Standards Institute. You will need a distributor, a partner or have your own operations and engineers in Europe so that you can follow what is going on in these myriads of standards committees.

Another area, and this is, as Mr. Horlick again indicated, a direct takeoff on our own Buy American Program, and certain aspects of the public procurement directives clearly are designed to force production in Europe or at least give privileged status to production in Europe and will have that effect. So I think you have to look at that. There are certainly certain areas in this program where there are definite advantages even programmed into the overall program to being an investor in Europe.

Representative **Hamilton**. I take it all of you think that the benefits that will flow to American companies are economies of scale, reduced border controls, access to new markets, and harmonized standards, all these things that are being used to sell European enterprises on 1992 will also benefit the United States; is that the general view of the panel?

Mr. COONEY. Yes, that's right.

Mr. HORLICK. Yes.

Mr. O'CLEIREACAIN. Yes, Mr. Chairman, but I would add that the economies of scale advantages vary enormously from industry to industry. There are a lot of industries that won't benefit very much.

Representative HAMILTON. Like?

Mr. O'CLEIREACAIN. Well, the ones that would benefit enormously are industries such as automobiles. There are also big economies of scale in aerospace. Industries where there are much smaller firms will not have the same advantage through economies of scale.

The Commission's own estimates of the benefits to come from the program rely more heavily on the economies of scale argument than they do on the reduction in border controls between the member-states.

Mr. HORLICK. Essentially one way of looking at this is a major deregulation. If you want to get it from 12 regulations to 1, that's positive in most businesses point of view.

As I mentioned, there are some lingering concerns in making sure that the regulations are done straight, but so far the overall view is positive. You can look at it, and if you're a U.S. small business that formerly exported to one country in Europe or had to export to 12 different standards, then obviously it's a plus if they only have to meet one standard, almost no matter how that standard is set.

Conversely, if you're an investor in Europe, a lot of U.S. companies who are already in Europe now face mainly difficult business decisions. What happened, an important bit of history is the EC grew from 6 countries to 9 to 12—well, 6 to 9 to 10 to 12, but that means a lot of companies find themselves with a plant that was put in the 6 and one that was put in the United Kingdom when it wasn't part of the 6 and one that was in Spain, and now you've tough business decisions of where do you put production, et cetera. So it will defy generalization.

Representative HAMILTON. Well, we'll proceed up here on the basis of about a 10-minute rule, and it may be of some passing interest that all of my colleagues on this panel this morning are from the State of New York which may indicate that New York has a very special interest in 1992, but we'll see how that develops. [Laughter.]

Congressman Solarz.

Representative SOLARZ. Thank you very much, Mr. Chairman.

I met recently with Lee Kuan Yew in Singapore and asked him for his assessment of Europe 1992. He expressed some concerns about the economic implications of this on the ground that there was a real possibility that in the EC's effort to harmonize their regulations, they would take the toughest standard or NTB which existed in any one country. As a consequence, it might end up being much more difficult to export than it is now because at present a company may have to contend with a stricter barrier in 1 country but not in the other 11. However, if the barrier for that 1 country becomes the barrier for all 12, it obviously is more difficult. How do you respond to that?

Mr. O'CLEIREACAIN. I think that's an exaggerated fear would be my personal opinion. As I said in my initial remarks, the position that the Community ultimately adopts has to be a compromise between the 12 member-states, and the voting procedures that are used for almost all, but not all, of the 92 directives involve the use of qualified voting, weighted voting arrangements where the big members have more votes. You can put together some scenarios in which a protectionist coalition could exist, but in general you don't find it.

On standards it's also worth pointing out that there is more involved here than just the 12 member-states of the Commmunity. The six member-states of the European Free Trade Area, EFTA, which is the largest trading partner of the Community, have free trade agreements with the EC, and those countries are intimately involved in the setting of European-wide standards that will cover 18 countries, and some of those EFTA countries may be in the process of joining the EC.

Mr. HORLICK. More technically, not only on product standards, but in general a lot of what the EC is doing is they are not setting so much one standard as saying if you meet the standard of a given member-state, then you can sell anywhere within the Community, which is a lowest common denominator.

As you can imagine, there are a lot of internal political reasons against adopting the toughest standard. The other 11 wouldn't like it. If you want a dramatic example, West Germany was forced to give up a beer purity law dating back to 1356 which kept out other countries' beers, although it's worth noting imports didn't go up in Germany because the German industry used this as free advertising to say they had the highest quality.

Mr. COONEY. I would just like to put in a little bit of a dissenting opinion if I can there. Certainly across the board at NAM many of our members are most concerned about the standards issues, and this includes even some very large companies, but particularly many of our smaller companies, and they share the kind of concerns that have been expressed to you by Mr. Lee Kuan Yew.

The problem that one has, and you have to make a very clear distinction between regulations and standards, the Reinheitsgebot, or the German Beer Purity Law—in English—was basically a regulation. It was literally the law and ditto with the Italian pasta law, for example.

Standards will be set basically by committees on a voluntary basis through an organization known as CEN/CENELEC, and basically there are something like 400 product committees there. It will be tremendously difficult in many cases for American companies to monitor what's going on in their specific product committee. We do not have a role and we are not allowed to play an observer role in those committees.

So there is some concern there, and it's not just among American companies or non-EC companies, but also within the EC itself, and I think I mentioned some of this in my report, but there is a generic concern with the reliance on German industrial standards, which would give German companies a systematic advantage over others throughout the communities. That's a big issue that is being discussed within Europe and being discussed probably on a product-by-product level.

It's not always the German case, it's not always German standards, but it tends to be because Germany has, No. 1, an excellent reputation in the standards area. Those standards are usually based on specific product designs that could cost other producers millions of dollars, or whatever the currency is whether it's in France, the United Kingdom or the United States, to conform to those product standards.

Representative SOLARZ. Mr. O'Cleireacain, in your prepared statement you made the point that the EC's protectionist record is fairly similar to that of the United States, and you said based on 1986 data, 13 percent of EC imports from developed countries and 23 percent of imports from developing countries were subject to hardcore nontariff barriers.

First, where does that data come from?

Mr. O'CLEIREACAIN. The data comes from the World Bank, from the World Bank World Development Report 1987, page 142.

Representative SOLARZ. And that data indicated that 15 percent of our imports from developed countries were subject to hardcore nontariff barriers. So that appears to indicate that we were marginally more protectionist than the EC.

Is it your expectation that come 1992 these percentages of hardcore NTB's in the EC will go down or go up?

Mr. O'CLEIREACAIN. I would not expect dramatic changes in the relative positions of the Community compared to the United States.

Representative SOLARZ. So you think these percentages will remain about the same?

Mr. O'CLEIREACAIN. Yes, sir.

Representative SOLARZ. Do the other witnesses care to comment?

Mr. COONEY. Yes. I have a statement on that, and I want to say two comments that I made very quickly.

First of all, the European Commission has said in its October 1988 statement on reciprocity that in taking national barriers and moving them to the European Level and changing them to the European level that there will be no general increase in the rate of protection. So at least their view is that at a minimum it will be about the same.

I just want to make one other comment because our witness made this comment before the Ways and Means Committee last month. At NAM at least we certainly don't view that the Europeans have the right to unilaterally take national barriers that may currently be registered with the GATT, such as the Italian barrier on cars from Japan, for example, and arrogate that to the European level and say now this is OK because it's the same level of protection. Our view is that we have a right to complain about this in the GATT.

Representative SOLARZ. You indicated in your prepared statement, Mr. O'Cleireacain, that there was going to be a protential 68-percent decline in U.S. exports of ADP and other office machinery which would be a fairly substantial decline in total U.S. manufactured exports to the EC. Where does the estimate come from?

Mr. O'CLEIREACAIN. These estimates are not my estimates, Congressman Solarz. These estimates, and I stress they are the upper end of the range of estimates, come from a document produed by some consultants to the European Commission looking at the costs of non-Europe. They come from volume 2 of the 16 volume study.

Representative SOLARZ. And on what is the basis for this notion that there would be such a sharp decline in U.S. exports of ADP?

Mr. O'CLEIREACAIN. It's based on a sample of only 10 selected industries which vary considerably in the extent to which they would benefit from economies of scale, and they are the results of an econometric trade model that assumed that after removal of the barriers between the member-states there would then be very vigorous competition between European corporations driving down prices and producing the maximum competitive benefit to the Community.

Representative SOLARZ. Thank you very much, Mr. Chairman.

Representative HAMILTON. Congressman Fish.

Representative FISH. Mr. Cooney, in view of the close association, and I think you brought this out, between the dollar's value and U.S. export performance, in your view, is additional dollar devaluation necessary?

Mr. COONEY. No. I think that if the dollar remains at the present level roughly on world financial markets that we should make major export gains from EC-1992. There are some industries that would benefit perhaps from an even lower dollar, but at the present time there are also some possible costs of a lower dollar, such as increasing inflation in the United States. After all, we import roughly a third of our capital goods now. So at the present time we think that the dollar should stay roughly at the current level, and with that we would probably realize major export gains in the European Community.

Representative FISH. Thank you.

This question goes to the panel. Does the large investment in the United States by European countries, in your judgment, tend to mitigate against the European Community attempting to shut the United States out?

Mr. HORLICK. Well, so far the EC has shown no desire to shut out U.S. capital. Something that worries a lot of U.S. businesses would be discrimination. U.S. businesses don't want to be discriminated against as exporters to the EC or as investors.

I think it's very clear from the Commission and from business groups within Europe that they realize that it's one world also, and they are very clear that they can't do something there that won't rebound against them here, and we frankly have to be aware that things we do here rebound against us. So in some sense everyone sees their interests at stake.

Mr. COONEY. Yes, I would like to echo that. I mean I think it's not a direct hostage situation. Rather, it's that both sides see that they have an interest in an open market for both investment and for trade, and I think that probably they—well, it's hard to say "they" because as I said in my testimony there are a lot of different voices in the European Community, but certainly the countries and the business communities with the highest levels of investment in the United States, such as the United Kingdom and Germany, have expressed strong concerns about any kind of protectionist policy that might be adopted by the EC.

Representative **Fish**. All right, they won't call it protectionism, but I think we have had evidence of European-wide consortiums and let's call it mercantilism. Now is that a threat?

Mr. **Cooney**. I'm not clear what you mean by the word "consortiums" there.

Representative **Fish**. I understand the case of the Airbus was an example of pulling together several resources.

Mr. **Horlick**. Technically, by the way, the Airbus is not an EC affair, but four member-states in fact. I think that's an internal question they always go through. The U.S. Government has been quite clear that it doesn't like what's going on with Airbus. I think Airbus is a pretty special case. I think what's interesting is the EC has formed a series of research programs in a variety of areas, and that's something where yes, the United States cares very much about whether U.S. companies will have access to that and should, especially in high technology.

The distinctions which Mr. Cooney mentioned between exporting and investing are blurring. There are some industries where you don't just put a computer in a box and ship it overseas. Business doesn't work that way. They want you on the spot, and industries like that, for purely competitive reasons you have to know what your competitors are up to. You have to be in the same market and you have to be in the same research project.

So that's an area where U.S. companies, and I know this is true of the Chamber and I assume it's true of NAM, that's one of the things that people keep an eye on to see if U.S. companies get discriminated against.

Representative **Fish**. Would that be actionable?

Mr. **Horlick**. That's an interesting question. The section 301 as written includes as actionable that which is unjustifiable, unreasonable, or discriminatory. So presumably something discriminatory is actionable under section 301. Whether it's actionable under GATT rules or other international rules I couldn't say.

Mr. **Cooney**. On the Airbus thing I want to say something, too, there. The specific concern we have there is the direct subsidization effect. We have supported at NAM, and I believe the Chamber has, too, but I think other business groups have, too, enhanced U.S. export financing specifically to counteract European financing of Airbus sales and other direct subsidization. You've a consortium here, and I think it's accurate to say it has lost money in every one of its 17 years of existence as a commercial entity. So it gets a high level of subsidization, and that certainly is a concern, that kind of consortium is certainly a concern of ours.

Representative **Fish**. My next two questions relate specifically to West Germany and then Eastern Europe, and I hope my friend and neighbor from Purchase, Westchester County, New York, will get in the act here.

West Germany I think we can agree is the economic growth engine in Western Europe, and in some respects I gather that West Germany's policies are different from their friends in the Community. I guess the question is when things settle down in 1992, what effect will this have on the stature of West Germany in Europe?

Will it enhance it, will it diminish it, or will it leave it pretty much the same?

Mr. O'CLEIREACAIN. Congressman Fish, I think it will enhance not just the German position, but the position of all of the member-states. It's rather separate from the 1992 program, but also covered by the enabling legislation in the Single European Act are provisions for European political cooperation among the 12 member-states. This is becoming of greater political importance all of the time, and I discuss it in some detail in my prepared statement.

Trade between East Germany and West Germany is presently considered as intra-German trade. There are no barriers in trade between the two Germanies. There is going to be a problem for the Europeans in the future if this intra-German trade provides East Germany with a window into an EC-wide market.

There are a number of other areas in which European political cooperation probably in the long term benefits the United States. The Community has already concluded trade agreements with a number of East European countries and is in the process of dealing with some others. We have seen recently a statement from the 12 member-states, under the European political cooperation process, attacking Romanian human rights violations, and the Community has recently stopped trade discussions with Romania.

Representative FISH. Does anybody have anything to add to that?

Mr. HORLICK. Within the Community it's hard to say how 1992 will shake out. If you would go back to 1957, I don't think people would have predicted the fantastic growth, for example, of the Italian economy. So I wouldn't care to hazard a guess.

Mr. COONEY. I would just say that the one aspect that we are particularly looking at there in terms of the German role is monetary policy and the role that Germany may play in establishing a common monetary policy. The possibility of a single currency and that type of thing is much further away.

Essentially the German concern with inflation has dominated the economic and monetary policy of Europe for the last several years, certainly under the EMS. That's likely to continue and has certain implications for European growth.

Someone mentioned to me yesterday that probably the No. 1 economic concern today in Germany is inflation, which is hard for us to believe because their inflation rate I think is considerably less than half of ours, but anyway that is the concern.

On the other hand, I would say that from our perspective at NAM our No. 1 economic concern with regard to the Germans is the large German current account surplus and the lack of any type of policy initiative really aimed at doing something about that. So that I would say is our major concern and where we see a German role being particularly interesting is in the area of monetary policy and a more unified monetary system in Europe.

Representative FISH. Thank you, Mr. Chairman.

Representative HAMILTON. Congressman Scheuer.

Representative SCHEUER. Thank you, Mr. Chairman.

In the last couple of months a number of members of Parliament from the European Parliament, half a dozen of them and a half a dozen Congressmen and Senators have organized a parliamentary group known as GLOBE, the Global Legislators Organization for a

Balanced Environment, and it's an interparliamentary group on a balanced environment.

What is the significance of 1992 to members of the European Parliament who are trying to enhance the environment and are trying to enhance the workability of EC controls and national government standards? Are we going to have a Gresham's law here of poor environmental legislation driving out excellence standards? Is it going to be the denomination of the lowest common denominator?

Mr. COONEY. Well, I'm sorry, I wish I had brought my copy of the Revised Treaty of Rome with me, but the answer to your question is that the Single European Act and the Revision of the Treaty of Rome addresses that directly. With respect to the question of the lowest common denominator setting standards, it says that in the areas of worker and consumer protection, and environment, the European Community shall have a high standard of protection. Bearing that in mind, there is very little possibility of their saying, "Who has the lowest standard here and let's just adopt that one."

I've talked to a number of companies in Europe in environmentally sensitive areas and they view the impact of tighter integration in 1992 will be to ratchet the level of environmental protection upwards.

Representative SCHEUER. That's encouraging. Where will that ratcheting upwards take place, in national Parliaments, in the European Parliament? Where is the action going to be?

Mr. HORLICK. Both places, It depends, and to give an example——

Representative SCHEUER. Well, let me just say that all of these problems, almost without exception, are transnational.

Mr. HORLICK. Right.

Representative SCHEUER. Acid rain is ravaging Europe, the Black Forests aren't the Black Forests any more, they are the yellow forests, they are dying, 50 percent of it is infected, groundwater respects not national boundaries and all of these problems that we've heard about and that we're worrying about. Acid rain, the greenhouse effect, global warming, the ozone, these are all transnational problems. How will they be treated?

Mr. HORLICK. If I had to hazard a guess, some environmental concerns are directly governed by EC-1992. The transport of hazardous substances, for example, will be directly covered by Community-wide regulation. What you are also seeing, and obviously you have seen it up front, is the impressive rise of environmental concern caused by things like the Black Forest turning yellow.

My own guess is the integration will make it easier to raise environmental standards Europe-wide because you don't have a problem of I guess what economists call the free rider, and no one is going to be able to sit it out and say I'll have my own pollution polluting zone where industry can have a free rein. So on balance I would bet it moves along in parallel with and aids the rise in environmental consciousness.

Mr. COONEY. If I could add to that just with respect to your specific question on the level, I think perhaps national implementing legislation may be the Achilles' heel here.

Representative SCHEUER. Say that again, the what?

Mr. COONEY. The need for national implementing legislation may well be the Achilles' heel of the environmental program because historically in a number of areas, not necessarily related to the environment, but historically in a number of areas the European Community, the member-states have lagged behind in adopting national legislation.

For example, we all know how frequently the Italian Government falls, and whenever the Italian Government falls all legislation is wiped off the books and you have to start all over again, and in a parliamentary system that can really slow down the process.

But the way it works basically is that the European Parliament is definitely involved because of its role in supervising and commenting on and amending proposals from the Commission that have to go back to the Council of Ministers. The Council of Ministers now can adopt environmental directives by a qualified majority instead of a unanimous vote, and that's an important change and has been mentioned several times here already, but then the National Legislature will have to implement it.

Now what if they don't? Then somebody basically has to sue them before the European Court of Justice. It could either be a party within one of the countries, a private party, or it could be another government that says country *A* is not implementing this European standard and therefore their polluted water is damaging our fisheries, or it could be the European Commission itself I believe under certain circumstances.

Representative SCHEUER. Could it be this new Parliamentary group?

Mr. HORLICK. I don't think so.

Representative SCHEUER. The individual Parliamentarians grouped together in a Parliamentary organization, a half a dozen members of the European Parliament would not have standing?

Mr. HORLICK. I'm not sure, and I would hate to guess. It's actually in the Treaty of Rome who has standing. I don't think they would have standing, but I'm not sure.

Let me take it a step further though because it's from a U.S. Government perspective and frankly this is looking way down the road. In talking about environmental concerns or product standards by 1995 or so Europe is going to be the biggest market in the world. Since 1945 we have been the biggest market in the world, and we just assumed that, and our trade policies and a lot of our other policies are based on the assumption that we're the biggest market in the world and people are going to do things to please us because we are the biggest market. I'm not sure we are ready for the shock when people start doing things to please the EC rather than us.

This affair with beef hormones is just the first taste, pardon the pun, of what the United States is confronting. I'm not saying this in terms of protectionism at all. It's simply that the EC said "this is what our consumers want."

Representative SCHEUER. Can I ask you, why do you use 1995 as a date rather than 1992?

Mr. HORLICK. By December 31, 1992, they are supposed to finish all the regulations and put them in force. Frankly, even if they don't, it's still going to be a success. I mean it's very visible.

Representative **Scheuer**. Won't Europe at that time be a bigger consumer market than the United States?

Mr. **Horlick**. Probably, and the reason I pick on 1995 is it's my estimate and I think most people's estimate that over the next few years, and I can't say when, you'll see some of the other European countries either joining the Community or de facto joining.

To give you an example, even if you feel that political neutrality prevents you from joining, you simply pass the same regulations and standards and that's going on in Western Europe.

Representative **Scheuer**. Of course, some of the Eastern bloc, Hungary, and I just got back from Hungary. I was there for that fantastic March 15 demonstration. Their heads are in the European Community.

Mr. **Horlick**. Well, I pick on 1995 because it's going to take a while. I mean assuming most of the regulations are done by 1992, and I assume they will be, I'm giving it a few years for the economic effects to take over and for people to react to it. But I do want to focus on the fact that at some point in the 1990's they are the biggest market in the world and we aren't, and that's a change for United States.

Representative **Scheuer**. Well, spell that out a little bit, what does that mean to us, particularly in this area of environmental standards which both the Congressmen and Senators as well as the European members of Parliament who are in this new group would like to see enhanced and raised.

Mr. **Horlick**. I'll just answer briefly, but if you want to also——

Mr. **O'Cleireacain**. One very quick point on it. This June the voters of the 12 member-states will once again reelect a European Parliament. The platforms of all of the cross-national political groupings contain an environmental plank.

Mr. **Horlick**. I'm not pointing to something hard and fast in the EC–1992 regulations. What I'm pointing at is a more generalized phenomenon more for political scientists I guess. If it's the biggest market in the world and if they adopt a common position on say chlorinated fluorocarbons that position is going to have a lot of weight in the world, a lot more weight than different positions of 12 member-states had a year ago, and that's going to be true of a lot of things we haven't even thought about.

Representative **Scheuer**. Just to put a footnote on that, you know we had the Treaty of Montreal where 130 nations decided that they would reduce production of CFC's by the year 2000 by 50 percent, and it was tough getting that agreement. Our State Department worked very hard and very diligently on it.

Now a couple of months afterward the Du Pont Corp. announced publicly that their recent research had led them to believe that we had to stop the production of CFC's not in the year 2000, but now, and not by 50 percent, but by 100 percent, and they do 60 or 70 million dollars' worth of production of CFC's.

So you're quite right. If the European parliament and the powers that be in this new Community are on something like CFC's, they will simply stop production in Europe. How will that affect the rest of the world? Is there going to be again a Gresham's law in effect here, or will there be a tendency to conform to that higher standard, that higher ethic?

Mr. HORLICK. Let's say you reconvene the same group that met at Montreal 10 years from now. If the EC is the biggest market and the biggest producer, people start paying more attention to them. It's not limited to environment and trade policy. This is going to be a phenomenally different world for the United States 5 years from now.

Representative SCHEUER. They will become the 600-pound canary and people will listen.

Mr. HORLICK. Well, we're not going to be a small canary and we are still a very big canary, but there are going to be two canaries and it's harder to arrange harmony. Life was a lot easier in 1946 when we had 50 percent of the world's output; 1992 for me will become a symbol of when we had to live in a more multipolar world.

Representative SCHEUER. Thank you, Mr. Chairman.

Representative HAMILTON. If you look at the two most recent trade disputes, one on beef hormones and the other on the removal of agricultural subsidies, it looks to me at least as if the European Community has won both rounds. What are the implications of that for 1992? We have backed down on both of those, right?

Mr. HORLICK. To defend my friends at USTR, they haven't tossed in the towel yet by any means, and I wouldn't say that it's a defeat for the United States.

Representative HAMILTON. Well, look, we wanted to put on the record right away the removal of agricultural subsidies. The agreement was we would put it off until 1991. We get some vague language, which is a very vague commitment for the future, but they are not going to do anything about agricultural subsidies in 1989 and 1990. We lose that. We backed down on agricultural subsidies, and the same thing happened on the beef hormones.

Now what are the implications of that? I mean they win on both counts against us on these immediate matters.

Mr. HORLICK. Let me run through hormones first as I understand it. My understanding of hormones, and I don't claim to be fully up to date on it, is we are looking for ways in which U.S. beef can be certified, but at the same time we are keeping our retaliation against the EC. So I think the U.S. Government at least would view it as a standoff, but you can ask them and not me.

On the agricultural subsidies what was being debated was really more the shape of the table, and I don't want to be too optimistic about it.

Representative HAMILTON. You don't consider that a victory for the United States on agricultural subsidies, do you?

Mr. HORLICK. No.

Representative HAMILTON. Do you on hormones?

Mr. HORLICK. I don't consider that either game is over. I consider we are in the middle or late innings. The real decision on that is at the end of the Uruguay Round historically, especially on agriculture, the decisions are made at the end at a very high level. What matters on agriculture and it matters a great deal to the United States.

Representative HAMILTON. Look, you're always going to keep the game going. I mean nobody is going to get up from the table and say you lost and we won. The fact of the matter is that in both cases the result has been favorable to the EC in the short term.

Mr. **Horlick**. What matters is that the United States and Europe manage to end the systems that have led to overproduction. Europe went from being the world's largest importer of sugar to the world's largest exporter, and from the world's largest importer of beef to the world's largest exporter. The effects worldwide have been incredible.

I'm not here for the U.S. Government, but the United States cannot give up its attempt to come up with a system worldwide, and that means Europe for sure, that stops that.

Now where EC-1992 come in, and that's what I was saying earlier. When the EC becomes the largest market in the world, a 600-pound canary, it's going to be a lot harder to say "you have to do this because we, the United States, are the world's largest market."

Representative **Hamilton**. It looks to me like they are already doing pretty well even though they are not a 600-pound canary.

Mr. **Horlick**. Well, it's a pretty big canary. Now from an EC point of view, just to switch sides, the EC point of view I think I can over generalize, and this is a sort of famous statement, is that agriculture is the glue that holds the EC together. You can also say it's the cement that keeps them from moving forward much and they spend a hell of a lot of money on agriculture.

Representative **Hamilton**. Well, what I'm concerned about here is the pattern. I mean what have we learned from this and how does it relate to 1992? Do we need to change our strategies in dealing with EC here?

Mr. **Horlick**. I think you're asking the right question. It's two phenomena. One, they will be the biggest market and, two, which is a psychological phenomenon you've seen also, what they are doing in Europe, as you've heard here, is very positive and they feel very good about what they are doing. They are building a more integrated market and it's better than killing each other, which they did twice this century.

When you have a government that feels good about what it's doing and it's a very large government, the United States has to rethink its trade strategy about Europe, as I mentioned earlier, and I think Senator Baucus has said this. To me this underlines the importance of the current GATT negotiations. It is vitally important to the United States that the United States get rules now that we want to live with and we want the EC to live with 10 years from now.

Representative **Hamilton**. Let me explore that with you just a moment. What is the relationship between 1992 and GATT? The European negotiators I presume are focused on 1992. Now how does that play?

Mr. **Horlick**. Technically there is no relationship in the following sense. The EC is the negotiator for Europe in the GATT and has been for some years, and the EC has been very explicit, the Commission in particular, that they are not violating the GATT. They say that everything they are doing is within any GATT rules. So in theory there is no relationship.

Now in practice obviously, and Mr. O'Cleireacain will want to comment, the timing is fortuitous. What I was focusing on just briefly is you have to look at what's going to happen to bargaining power as they get bigger and feel very positive about what they have been doing. They are going to feel very powerful, but there is a timing issue that I think you hit.

Mr. O'Cleireacain. There are a couple of points I would make. Within the bureaucacy of the Commission in Brussels there is going to be some consistency in the positions that are adopted. The trade negotiators for the Commission are not going to be adopting positions which are contrary to what other parts of the bureaucracy are proposing under the 1992 program, and we've seen that already.

But as I mentioned in my prepared statement, it's fortuitous that the timing of the two coincides because it provides an opportunity for the Community's trading partners to have some impact. We have seen that already in the case of the Uruguay Round discussions on financial services where the Community's position in its draft Second Banking Directive has been amended to take account of U.S. objections. There are some other problems down the road still to be faced during the Uruguay Round, particularly in the area of government procurement.

Mr. Cooney. I just want to add something there, too, and that is that I think GATT includes more than the Uruguay Round. It has been mentioned several times in most of the statements made by the commission on reciprocity, particularly the one last October, that the EC intends to honor all of its existing GATT commitments.

But this does not necessarily mean that all the issues that may arise from EC-92 and related subjects I think will be covered in the GATT Uruguay Round. I'll just give you one example, the problem of procurement.

Some people are very excited in the United States that the Europeans for the first time have brought certain excluded sectors—telecom, water, energy, and transport—into play with respect to opening them up not just within Europe, which has not been opened, but also specifically with respect to international non-EC producers getting access to that market.

Representative Hamilton. Is there any evidence that the EC is dragging its feet on GATT because of 1992?

Mr. Cooney. You know, I really don't think so. I think that the issue that you've brought up here, agriculture, I think it's not direct related or as directly related to the EC-92 issues. That's what I think the situation is there, because I think that the agricultural issue is a genuine issue in Europe as related to social affairs.

Can I just make one more point there, if I may, Mr. Chairman. I think there are issues under 1992 that Europe does not particularly want discussed in the Uruguay Round, such as public procurement. Why? Because there are certain players in the Uruguay Round, less-developed countries, that they do not want to have to discuss their issues in connection with opening the public procurement market. I think there they might consider negotiations under existing standards or procurement codes, but only with the countries, such as the United States, that have signed those codes.

Representative **Hamilton**. Before turning to Congressman Fish, I want to just get your impressions really about two things. Sometimes you hear the complaint that the United States is now losing investment because companies fear they are going to be locked out of Europe and they invest now in Europe rather than investing in the United States. What's your reaction to that? Is that happening, do you know at all?

Mr. **Horlick**. It's only impressionistic. I have talked with a number of very large U.S.-based businesses about 1992 and they don't talk in terms of shifting investment to Europe. They talk about the kind of business decisions I mentioned about how to rearrange their European production. It's not viewed that way.

Representative **Hamilton**. Mr. O'Cleireacain.

Mr. **O'Cleireacain**. I would add one thing. As part of the 1992 program there are going to be plant closings in Western Europe. There will be plant closings, particularly of small- and medium-sized enterprises rather than large U.S. subsidiaries. I think most U.S. subsidiaries already have operations in Western Europe and there is going to be some expansion in that investment rather than a shift of production out of the United States into Western Europe.

Representative **Hamilton**. Why do you say plant closings?

Mr. **O'Cleireacain**. Oh, the Commission's estimates show that. If you're going to have the benefits that come from economies of scale, small firms are going to have to close.

Representative **Hamilton**. Some are going to be knocked out of the market.

The other impression I wanted to get is really a reaction to the U.S. business community on these various concerns that you've all expressed, standard setting, local content, rules of origin, and so forth. Does the American business community generally feel that they have been part of the action, that they have been included in the regulations that are being issued, or do they feel they are being excluded?

Mr. **Horlick**. I wouldn't say that there is a uniform reaction. Let me put in a plug for the American Chamber of Commerce in Brussels, by the way, which does a superb job of tracking all this and communicating. Some companies complain that they are excluded and other companies say that they are able to have access as needed.

Representative **Hamilton**. Is there any pattern to that that you can see?

Mr. **Horlick**. I sort of go back to where I started. It's watchful waiting. People think EC 1992 is positive, but they are keeping their powder dry.

Mr. **Cooney**. There has been a pattern of exclusion in the standards area, and I think what's happening now is the two sides are building bridges, and it's not clear whether the bridges are going to meet over the middle of the river, but at least steps are being taken by the standards body, whom I mentioned earlier, CEN/CENELEC, to try to publicize standard setting procedures more in advance because their rules do not allow for non-European, and I use the word "European" in a broad sense, EFTA as well as EC.

Mr. **Horlick**. But that includes U.S. companies in Europe.

Mr. **Cooney**. Yes, that includes U.S. companies in Europe. So if a U.S. company is in Europe, they are able to participate. Even there I have heard expressions of dissatisfaction by some companies because their ability to participate at the national level in some countries is different to others. So even there there isn't certainly complete satisfaction with access.

CEN/CENELEC has now committed to publicizing the standards projects earlier, and I would go back to the comment that Mr. Horlick used, that the jury is still out on how well that will work. They have just started doing that enhanced publicity.

Representative **Hamilton**. Congressman Fish.

Representative **Fish**. Thank you, Mr. Chairman, and I'll be brief. I have just two questions.

The panel minimized what you were asked about, the shift in investment by American companies to Europe. I must have read the same thing the chairman did, and I thought it was quite a real change in policy.

Now let's assume that it is true, that there will be this shift in investment to Europe, could the panel comment on the effect this would have on our trade deficit?

Mr. **Horlick**. The evidence shows, as Mr. Cooney mentioned, that exports tend to follow investment. Without wishing to be an economist, which I'm not, my understanding is the problem the United States has is lack of investment in plant and equipment here. That's what we need more of, and we're not going to be able to export if we don't have the plant to make the goods.

Mr. **Cooney**. Yes, I would agree with Mr. Horlick's point, and only add just factually that I believe you'll find, especially if you look over the statistics of the last decade or so, that most new investment in Europe is from reinvested earnings in Europe.

Now there will be some new investment flows from companies that maybe do not have much presence in Europe yet and want to increase that presence. I think that will happen. So I think you will see some increase in new investment and new capital outflows to Europe, but on the whole I think the new investment will be financed from reinvested earnings of American companies or financed directly from borrowings in Europe.

Representative **Fish**. We have touched, a couple of us, on Eastern Europe, but I just wanted to get back to that with one question. How will Europe 1992 affect Eastern Europe, trade with Eastern Europe, especially the countries of Poland and Hungary, and I guess the Soviet Union?

Mr. **O'Cleireacain**. I'm not a specialist on East-West relations, Congressman Fish, but in my prepared statement I looked at this political cooperation process which, as I said, is separate from the 1992 process, but they are becoming interlinked and we are going to see the Community acting as a larger player in East-West relations than in the past.

You can conjure up some interesting scenarios that involve both the Community, EFTA, and some countries within Eastern Europe. It's possible that down the road an EFTA member such as Austria might apply or become a member of the Community. That will add one more neutral to the existing 12 member-states that contain at the moment just one neutral, my own country, Ireland.

If you then begin to get a two-track European political cooperation process, a NATO track and a neutral track, occurring within the Community's policies toward Eastern Europe, there is likely to be some conflict with the United States, but there are also likely to be some opportunities to encourage the logjam that is beginning to break up in Eastern Europe.

Mr. HORLICK. Just again looking historically, the EC has a history of special economic relationships, somewhat like our Caribbean Basin Initiative in the past. They have had them with former colonial territories, the Lome Convention, the special agreement with Israel, the whole history of these, and I would expect to see that replicated with Eastern Europe. You won't see a single policy toward Eastern Europe. You'll see coming down the road an agreement with Hungary, a separate agreement with Poland, and a separate agreement with the Soviet Union.

Again, frankly, this may not be what the U.S. Government wants. I mean the EC may decide to do something that isn't completely coordinated with U.S. Government policy and they will be much more inclined to do so than in the past.

Mr. COONEY. There is one other issue I would like to mention at this point, and that is the question of export controls. There is nothing on the table in the European Community with respect to common export control policies.

Most people in the exporting community in the United States who deal with this issue feel that one must emerge, that there simply will have to be a common EC export control policy presumably coordinated through or with COCOM, but we don't know that, and of course already we have substantial differences between U.S. export control policy and that of the individual European nations. So there are some differences, and we also have a common COCOM list.

That could emerge as a major issue, particularly in the context of enhanced EC efforts to trade with Eastern Europe, especially if an American company attempts to sell a product or locate a facility in Western Europe and then the U.S. Government says, but what's going to happen with this product, where is it going to go, and if the European common list doesn't contain it, then we have a problem with respect to that transaction.

That I think is a real issue. It has been used by the Europeans several times to justify as to why they should discriminate against American investors or American products. They say, we can't rely on this product because you may control it and then we can't sell it wherever we want to around the world and enhance our trade competitiveness.

Representative FISH. Thank you.

Representative HAMILTON. Let me ask you to think about the implications of 1992 beyond the economics of it. What are the political and security implications of 1992? I'm trying to peer into the future a little bit here. I've heard people say, for example, that an inevitable result of 1992 economic integration will be accelerated political integration.

Mr. O'CLEIREACAIN. Mr. Chairman, we are moving down that road. If one compares the calendar within Western Europe with the calendar in the United States and begins at point zero as being 1776, the Community is now up to 1814.

Representative **Hamilton**. You have to spell that out a little bit for me I guess. [Laughter.]

Mr. **Horlick**. Isn't that when you burned the White House? [Laughter.]

Mr. **O'Cleireacain**. That was another member-state. [Laughter.]

If one dates the current European political experiment from the treaty which set up the European Coal and Steel Community in 1951, and compares 1951 with 1776, we would now be up to, as I said, 1814.

The Europeans are involved in a process of institution building. Nobody knows what the end of the road will be and whether it's something similar to the United States. They are clearly learning from the United States.

Representative **Hamilton**. You would agree with the general observation that the economic integration will accelerate the political developments? As a general proposition you would agree with that?

Mr. **O'Cleireacain**. Yes, Mr. Chairman. From the beginning economics has been a means toward a political end, even though there isn't agreement on the end.

Mr. **Horlick**. But I don't know how fast. They have been coordinating politically for a while. Again, just to put it in historical perspective, the one thing that is quite sure is they won't kill each other again, and they are not going to have a European war. From the point of view of 20th century history, that's a big plus.

Representative **Hamilton**. What about a European Central Bank, common currency, where does that fit into all of this?

Mr. **Cooney**. I would just say that I think enhanced macroeconomic coordination is probably more important than ultimately coming up with a single currency when you try to agree on whose picture should be on the currency, should it be Jean Monnet or whoever.

I think we shouldn't therefore ignore the degree of coordination that has already occurred over the last 10 years. The EMS just celebrated their 10th anniversary.

Representative **Hamilton**. But you don't think that leads to a European Central Bank necessarily?

Mr. **Cooney**. What I'm trying to say is that I'm not sure how important it actually is to have a single European Central Bank if the Bundesbank, for example, which through the deutsche mark and through the deutsche mark's role in the EMS, is already effectively calling the tune.

Representative **Hamilton**. How should the United States look at proposals for a European Central Bank? Is that a good thing or a bad thing from the standpoint of the United States?

Mr. **Cooney**. People say sometimes to me well, we're really worried because if there is increased European cooperation, then it will mean tougher competition for the United States and our markets worldwide. I guess what we would have to say is that good policy is good policy and we should not discourage the Europeans from following good policy.

Representative **Hamilton**. Is a European Central Bank good policy?

Mr. Cooney. Well, that's I think their decision. I really can't answer that. All I'm saying is that I think you can't have the internal market developing in the way they foresee it without closer monetary and economic cooperation, and certainly our companies are going to benefit from the most important step that has been taken so far which is the total liberalization of capital movements in 1990.

Representative Hamilton. Would any of you predict a European Central Bank in the next 5 years after 1992?

Mr. O'Cleireacain. Five years, no, Mr. Chairman.

Mr. Horlick. In 5 years, no.

Mr. Cooney. Five years after 1992?

Representative Hamilton. Yes, in the late 1990's.

Mr. Cooney. I could see a Federal Reserve type system emerging by then.

Mr. Horlick. But think about the decisionmaking. Right now we already deal with the main players on monetary affairs in Europe. If there is a European Central Bank at some point, its decision won't be by one person, but it will be by the same players we're already dealing with. So it may not be that different.

Representative Hamilton. Well, I'm told that we are going to be voting very shortly.

I just want to thank all of you for an excellent presentation, not only in your prepared statements, but in your responses. It has been a pleasure to have you before us this morning.

Thank you very much, and the committee stands adjourned.

[Whereupon, at 11:58 a.m., the committee adjourned, subject to the call of the Chair.]

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Prepared by Hunter Monroe

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